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The Operation and Effect of the Domestic International Sales Corporation Legislation

1980 Annual Report

Department of the Treasury
December 1982

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THE SECRETARY OF THE TREASURY

WASHINGTON

15 NOV 1982

Dear Mr. Speaker:

Section 506 of Public Law 92-178, the Revenue Act of 1971, provides that the Secretary of the Treasury shall submit an annual report to the Congress setting forth an analysis of the operation and effect of the provisions of that Act which authorize the creation of domestic international sales corporations (DISCs).

Pursuant to that section, I hereby submit the ninth annual report entitled "The Operation and Effect of the Domestic International Sales Corporation Legislation."

The report follows the format of earlier reports in examining the effect of the DISC provisions on U.S. exports and the revenue costs associated with the provisions.

Since the last report on DISC was prepared, there have been at least two developments of which you should be aware. First, DISC has come under increasing challenge by our world trading partners, who see it as an export subsidy which violates the General Agreement on Tariffs and Trade (GATT) and as an irritant to international trade relations. While we do not necessarily agree with this view, the Administration is exploring possible ways to address the concerns of its trading partners. Secondly, the Tax Equity and Fiscal Responsibility Act of 1982 reduces DISC benefits for corporate shareholders by 15 percent for tax years beginning after 1982.

I am sending a similar letter to the President of the Senate.

Sincerely,

Donald T. Regan

Donald T. Regan

The Honorable
Thomas P. O'Neill
Speaker of the House of Representatives
Washington, D.C. 20515

Enclosure

TABLE OF CONTENTS

		Page
Chapter 1.	Introduction and Summary	1
Chapter 2.	History and Provisions of DISC Statute	3
Chapter 3.	The Effect of DISC on the Level and Structure of U.S. Trade	7
Chapter 4.	Effect of DISC on Tax Revenues	17
Chapter 5.	General Statistical Information	26
Appendix A	Definitions and Sampling Procedure	34
Appendix B	Information Used to Estimate DISC Effect	37

FIGURE AND TABLES IN THE REPORT

	Page
Table 3-1 Gross Receipts, Net Income and Tax-deferred Income by Major Product Class - DISC Year 1980	9-10
Figure 1	12
Table 3-2 Estimated Reduction in Exports if DISC Were Eliminated - DISC Year 1980	13
Table 4-1 Revenue Cost Estimates and Projections, Actual Tax Rates and DISC Provisions	19
Table 4-2 Gross Receipts, Net Income and Tax-deferred Income by Asset Size of Corporate Majority Shareholder - DISC Year 1980	22
Table 4-3 Gross Receipts, Net Income and Tax-deferred Income by Size of Gross Receipts of the DISC - DISC Year 1980	23
Table 4-4 Gross Receipts, Net Income and Tax-deferred Income by Size of Net Income of the DISC - DISC Year 1980	24
Table 4-5 DISC Elections	25
Table 5-1 Historical Statistics, DISC Years 1977-1980	27
Table 5-2 Gross Receipts, Net Income and Tax-deferred Income by Accounting Period - DISC Year 1980	28
Table 5-3 Gross Receipts, Net Income and Tax-deferred Income by Pricing Method - DISC Year 1980	29
Table 5-4 Balance Sheet Statistics - DISC Year 1980	31
Table 5-5 Income Statement Statistics - DISC Year 1980	32
Table A-1 Summary of Sampling Results	36
Table B-1 Elasticities of Export Demand and Supply Assumed in Each Major Category	37
Table B-2 Specific Products in Each Major Category	38

Chapter 1 - Introduction and Summary

This report is the ninth in an annual series on the operation and effect of the domestic international sales corporation (DISC) legislation. A DISC is a special corporation that allows the deferral of income tax on a portion of export profits. The report covers the eighth full year of DISC operations. It presents statistical estimates derived from a sample of tax returns, Form 1120-DISC, filed for accounting periods ending between July 1, 1979 and June 30, 1980, referred to as DISC year 1980.

The scope of DISC activity measured both by export receipts and net income continued to expand in DISC year 1980. DISC exports of manufactured goods increased 28 percent from DISC year 1979 to $94.1 billion. Net income attributable to DISC manufactured exports rose 30 percent to $7.7 billion in DISC year 1980.

Chapter 2 discusses the 1971 DISC legislation and the modifications to the original legislation in the Tax Reduction Act of 1975 and in the Tax Reform Act of 1976, which restricted DISC benefits to increased, rather than total, export sales.

Chapter 3 discusses the impact of the DISC legislation on U.S. exports. The extent to which DISC increased U.S. exports in DISC year 1980 over what they would otherwise have been, is estimated to range between $6.2 billion and $9.4 billion. This represents an increase of approximately 36 percent over DISC year 1979. The range is based on a consideration of the conditions of demand and supply in various product categories. DISC tax savings increase the profitability of exports and, therefore, stimulate an additional supply of exports. The extent to which export supply is stimulated depends on the responsiveness of supply to the change in the profitability of capital used for export production.

Beginning in DISC year 1981 the export incentive effect of DISC will be reduced by the Accelerated Cost Recovery System (ACRS), which was introduced in the Economic Recovery Tax Act of 1981 (ERTA). ACRS increases the after-tax return on capital overall by reducing taxable income. The effect of ACRS, therefore, is to reduce the relative differential conveyed by DISC with respect to the after-tax return on capital. By the same token, ACRS reduces the incentive of DISC for production for export relative to production for the domestic market.

As is shown in Chapter 4, the revenue cost of DISC in DISC year 1980 was $1,410 million, assuming a marginal tax rate of 46 percent. This amounted to a 42 percent increase over DISC year 1979. The increases in the export effect and revenue cost of

DISC reflect the growth in U.S. exports, the growing DISC share of total exports, and the larger percentage of DISC profits that could be deferred in DISC year 1980.

Assuming the statutory corporate rate of 46 percent in making the revenue estimates ignores the effect of net operating losses and excess tax credits, which may significantly reduce the marginal tax rate on tax-deferred income. If there are substantial net operating losses and excess tax credits that cannot be carried forward in the absence of DISC, the revenue cost of DISC would be significantly less than the estimated values. However, the export impact of DISC would also be reduced in approximate proportion to the reduction in the revenue cost.

Summary income and balance sheet statistics derived from DISC returns are presented in Chapter 5. The consolidated profit margin earned on DISC exports of manufactured goods decreased from 14.1 percent in DISC year 1979 to 13.9 percent in DISC year 1980. Tax deferred income was 19.3 percent of the consolidated income from manufactured exports by DISCs. Net income reported by all DISCs was $8.4 billion. Transportation equipment, non-electrical machinery, and chemicals -- in that order -- accounted for the largest dollar amounts of DISC income.

Chapter 2 - History and Provisions of DISC Statute

Provisions of the Original DISC Legislation

Title V of the Revenue Act of 1971 provided for the creation of Domestic International Sales Corporations (DISCs). Its objective was to stimulate an increase in exports by lowering the effective rate of taxation of export income. The legislation provided a tax deferral for part of the export income channeled through a DISC. A DISC is exempt from federal income tax, but its shareholders are taxable on dividends distributed or deemed distributed by a DISC. Until 1976, the shareholders of a DISC were generally deemed to receive an annual dividend equal to one half of the DISC's taxable income, even if the DISC distributed less. This deemed distribution was fully taxable to the shareholders. Federal income tax could be deferred on the remaining half of the DISC's taxable income, until the income was actually distributed to the DISC shareholders, a shareholder disposed of the DISC stock, the DISC was liquidated, the corporation ceased to qualify as a DISC, or the DISC election was terminated or revoked by the shareholder(s).

To qualify for tax exemption, a DISC must be incorporated under the laws of any state or the District of Columbia, have only one class of stock, have outstanding capital stock with a par or stated value of at least $2,500, elect to be treated as a DISC, and satisfy the "gross receipts" and "gross assets" tests.

The gross receipts test requires that at least 95 percent of the corporation's gross receipts consist of "qualified export receipts." In general, qualified export receipts are to be derived from the sale or lease for use outside the United States of "export property," or from the furnishing of services related and subsidiary to the sale or lease of export property. Also included are dividends on stock of a "related foreign export corporation" and interest on any obligation which was a "qualified export asset." "Export property" is defined as property manufactured, produced, grown, or extracted in the United States. Exports subsidized by the U.S. Government or exports intended for use in the United States do not qualify as export property. A DISC may not engage in producing, growing, or manufacturing export property.

The gross assets test requires that at least 95 percent of the corporation's assets be qualified export assets. In general, qualified export assets include inventories of export property, necessary operational equipment and supplies, trade receivables from export sales (including commissions receivable), producer's loans, working capital, investments in related foreign export corporations, obligations issued, guaranteed, or insured by the

Export-Import Bank or the Foreign Credit Insurance Association, and obligations of domestic corporations organized solely to finance export sales under guaranty agreements with the Export-Import Bank.

If a DISC fails to meet either the gross receipts or gross assets test, it may continue to qualify as a DISC by making a pro-rata distribution to its shareholders equal to the portion of the income attributable to the ineligible receipts or equal to the fair market value of the unqualified assets, depending on the nature of the disqualification. However, if a DISC is disqualified, or otherwise terminates its status as a DISC, the deferred tax becomes payable over a period of time.

A DISC usually acquires export property from its parent corporation or an affiliated corporation ("related supplier") and then sells the property abroad; however, it can act simply as a commission agent. In many cases, a DISC is a "paper" corporation without any employees or real operations. The method used for allocating income between a DISC and its related suppliers therefore is an important part of the DISC statute. The allocation is achieved through special intercompany pricing rules which permit the DISC to realize taxable income in an amount which does not exceed the greater of:

(a) 4 percent of the qualified export receipts attributable to the sale of export property plus 10 percent of related "export promotion expenses," defined as ordinary and necessary expenses incurred to obtain qualified export receipts (referred to as the 4 percent method);

(b) 50 percent of the combined taxable income of the DISC and its related supplier attributable to qualified export receipts plus 10 percent of related "export promotion expenses" (referred to as the 50-50 method); or

(c) taxable income based upon the price actually charged the DISC by its related supplier if that price is justifiable on an arm's-length basis (referred to as the arm's-length method).

Under marginal costing rules, if the 50-50 method is used by the DISC, only the marginal or variable production and sales costs for the export property need be included in the computation of combined taxable income. In general, the benefits of marginal cost pricing are limited, however, to instances where the variable cost margin on the DISC's export sales of a product is less than the full cost margin on the combined sales of the product by

the DISC and the related supplier. Neither the 4 percent method nor the 50-50 method can be applied in such a way as to cause a loss to the related supplier while the DISC is earning a net profit. These special intercompany pricing rules allow exporters to allocate more income to a DISC, and thus to defer a larger portion of their total tax burden, than they would be able to under the normal arm's-length rule.

Statutory Amendments

The Tax Reduction Act of 1975 denied DISC benefits to profits arising from exports of products in short domestic supply, as determined by the Commerce Department under the Export Administration Act of 1969 or by Executive Order of the President. The Act also removed DISC benefits from exports of natural resource products, such as oil, gas, and minerals, subject to a percentage depletion allowance. The Tax Reform Act of 1976, excluded renewable resources, such as timber, from the natural resource products ineligible for DISC benefits.

The Tax Reform Act of 1976 included the incremental provisions, effective for accounting periods beginning after December 31, 1975. Under these provisions, DISC benefits (deferral of tax on one half of profits) are limited to income attributable to export gross receipts in excess of 67 percent of average export gross receipts in a 4-year base period. For taxable years beginning in 1976 through 1979, the base period years are 1972 through 1975. Starting with taxable years beginning in 1980, the base period is advanced each year. For example, the base period is 1973 through 1976 for taxable years beginning in 1980, and 1974 through 1977 for taxable years beginning in 1981. 1/ DISCs with adjusted taxable income of $100,000 or less are exempt from the incremental rule. This exemption is phased out as adjusted taxable income increases from $100,000 to $150,000.

In applying the incremental rule, a DISC's export gross receipts are treated as equal to zero for those base period years in which the DISC did not exist. In order to prevent a controlling shareholder from gaining an advantage by shifting exports from one DISC to another, the sales of all DISCs that are

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1/ For an analysis of the effect of the incremental provision on the incentive to expand exports, see the 1976 Report, pages 15-16 and 53-58. It is demonstrated there that, for the same increase in tax revenue, an across-the-board reduction in the DISC deferral rate might have had a slightly more favorable impact on the incentive to expand exports than the more complicated 1976 provision does.

part of a controlled group are combined in calculating base-period exports. Appropriate allowance is made for base-period sales of products no longer fully eligible for DISC benefits, such as natural resource products.

The incremental provisions enacted in 1976 reduced DISC benefits for eligible export products initially by about 40 percent for taxable years beginning after December 31, 1975. 2/

The 1976 Act made additional amendments to the DISC legislation. The most important of these was to reduce the DISC deferral on sales of military goods to one half the amount which would otherwise be allowed. The 1976 Act also lengthened the period for recapture of the deferred tax, in the event of disqualification or termination of DISC status, to twice the number of years of the DISC's existence, up to a maximum period of 10 years.

The Tax Equity and Fiscal Responsibility Act of 1982 increased the deemed distribution by a DISC to a corporate shareholder from 50 percent to 57.5 percent of taxable income. The provision, which reduces DISC benefits for such shareholders by 15 percent, applies for tax years beginning after 1982.

2/ The amount of the reduction is estimated by comparing the ratios, for periods before and after the 1976 Act was effective, of DISCs' tax-deferred income to net income. Statistics in the 1977 and 1978 Reports indicate that this ratio was .49 in the last full year before the Act came into effect, and .29 in the first full year to which the Act applied (the last part of DISC year 1977 and the first part of DISC year 1978). The ratio of tax-deferred income to net income increased to .32 in DISC year 1979 and to .36 in DISC year 1980 because the base period remained unchanged.

Chapter 3 - The Effect of DISC on the Level and Structure of U.S. Trade

As in last year's report, this report offers a range of estimates of the impact of DISC on exports based on assumed responses to increased supplies made possible by DISC. Until last year, the reports compared the growth in DISC and non-DISC exports and presented a specific estimate of the impact of DISC on exports. This DISC/non-DISC comparison is no longer used because of the limitations explained in Appendix B of the 1979 report.

Any analysis of the impact of DISC on exports must be done against the background of the $138 billion growth in exports that occurred between 1971 and 1979. While U.S. exports increased substantially, the U.S. share of free world exports of manufactures declined from 19.7 percent in 1971 to 17.4 percent in 1979. 1/ DISC exports of manufactured goods as a share of total U.S. exports of manufactured goods, however, rose from 65.7 percent in DISC year 1979 to 66.7 percent in DISC year 1980. 2/

DISC increases the profitability of exporting and therefore stimulates an increase in export supply by U.S. producers. Labor and capital are drawn into the export sector. The extent to which a reduction in costs or an increase in price induces the expanded production of exports is indicated by the price elasticity of supply. The stimulating effect of DISC on exports therefore depends on supply and demand responses, combined with the shift in export supply brought about by DISC.

1/ All aggregate trade data are taken from the quarterly publication by the U.S. Department of Commerce, International Economic Indicators.

2/ Statistics on DISC exports of nonmanufactured products, specifically agricultural products, exceed actual U.S. exports from all sources by a substantial margin because of sales between unrelated DISCs. That is to say, one DISC may sell to another DISC. As long as the property sold is ultimately for direct use, consumption, or sale outside the United States, its sale is a qualified export receipt. Therefore, comparisons between DISC exports and total U.S. exports of agricultural products do not lead to any meaningful comparisons. Inter-DISC sales may also add some error to the statistics on manufactured exports.

The impact of DISC on exports is estimated by first classifying the specific products listed in Table 3-1 into four categories with differing supply and demand behavior. The responsiveness of export supply is generally assumed to be very high. One reason is that output can easily be diverted from domestic demand, which for most goods is much larger than export demand. If the return from diverting output is positive, the destination of sales will change until the return from selling in either market is identical. Furthermore, many goods are produced with standard, widely diffused technologies so that labor and capital can easily be shifted from other uses in order to expand output. Demand is also highly responsive where standardized commodities are sold in many markets, as in the case of farm products. The responsiveness of demand is somewhat lower in cases in which products are more differentiated, or have to be adapted to particular markets.

The four categories into which products are classified are:

1. Nonmanufactured products (mainly agricultural commodities). These are products whose demand is very highly responsive to price changes because identical products are supplied and demanded by many countries. For example, grains are sold in standard grades in many markets. The elasticity of export supply is a function of the elasticities of domestic demand and supply and the proportion of U.S. output that is already exported. The smaller the domestic demand and supply elasticities and the larger the proportion of U.S production going to export, the smaller the export elasticity of supply. These three factors combine to make the export elasticity of supply of agricultural commodities not as high as the export supply elasticity in manufacturing.

2. Basic manufacturing industries not requiring advanced technology. These products include textiles, rubber, fabricated metal products, and transportation equipment other than aircraft. The elasticity of supply is high because products tend to be relatively standardized in most world markets; hence little change in these products is required to adapt them to export, compared with domestic, markets. Moreover, since these products use relatively standard technologies, capital and labor can easily be adapted to expanded production. Since these products are so little differentiated, their elasticity of demand is also quite high.

3. High technology manufactured products. Examples include chemicals, aircraft, electrical machinery and equipment, and office machinery. It is assumed that

Table 3-1

Gross Receipts, Net Income and Tax-deferred Income by Major Product Class 1/ - DISC year 1980
(Dollar Amounts in Millions)

Major Product Class	Number of Returns	Gross Receipts	Net Income	Tax-deferred Income	Deferred Tax as a Percent of Gross Receipts 3/
Total	7,933	131,976	8,426.5	3,065.9	1.1
Nonmanufactured products	953	37,867	728.1	284.4	0.3
Agricultural products	302	35,731	520.8	205.7	0.3
Grains	119	32,816	445.5	178.4	0.3
Other agricultural products	183	2,915	75.3	27.3	0.4
Mineral products	58	819	35.9	16.6	0.9
Other	593	1,317	171.4	62.1	2.2
Manufactured products 2/	6,980	94,109	7,698.4	2,781.5	1.4
Ordnance and accessories	22	195	22.5	5.5	1.3
Food and kindred products	273	3,207	179.5	66.5	1.0
Meat products	77	936	47.3	18.1	0.9
Canned fruits, vegetables, seafood	56	699	43.6	17.7	1.2
Grain mill products	30	519	31.7	9.9	0.9
Tobacco manufactures	12	903	79.0	30.7	1.6
Textile mill products	247	1,629	96.8	38.2	1.1
Apparel, etc.	151	359	19.8	7.0	0.9
Lumber, etc., except furniture	197	2,981	98.3	36.5	0.6
Saw and planing mill products, logging	46	1,481	33.4	12.7	0.4
Millwork, veneer, etc.	60	359	13.5	5.0	0.6
Furniture and fixtures	28	46	4.7	2.1	2.1
Paper and allied products	141	2,029	163.0	49.9	1.1
Printing, publishing, etc.	96	300	35.8	13.1	2.0
Chemicals and allied products	521	13,272	1,318.8	486.1	1.7
Inorganic, organic chemicals	85	5,716	669.7	247.5	2.0
Plastics materials, etc., including fibers	76	3,436	310.9	119.4	1.6
Drugs	45	642	99.6	32.4	2.3
Agricultural	43	1,483	79.1	25.9	0.8
Rubber and miscellaneous plastic products	136	869	54.8	20.4	1.1
Leather and leather products	84	577	16.9	7.0	0.6

Table 3-1 Continued

Major Product Class	Number of Returns	Gross Receipts	Net Income	Tax-deferred Income	Deferred Tax as a Percent of Gross Receipts 3/
Stone, clay, glass and concrete products	68	898	83.6	32.9	1.7
Primary metal industries	244	2,671	146.1	56.4	1.0
Iron and steel industries	53	801	46.2	14.9	0.9
Fabricated metal products	701	3,625	301.8	118.2	1.5
Cutlery, etc.	80	197	17.9	7.7	1.8
Heating and plumbing	73	150	11.4	4.8	1.5
Structural metal products	81	443	38.0	15.1	1.6
Machinery, except electrical	1,465	20,385	1,693.5	588.3	1.3
Engines and turbines	40	4,546	398.3	127.9	1.3
Farm machinery and equipment	110	1,171	65.1	21.9	0.9
Construction, mining, etc.	273	6,257	411.7	141.3	1.0
Metal working	118	527	48.9	17.2	1.5
Special industry	420	2,838	245.9	93.4	1.5
Office, etc.	49	2,518	303.3	114.1	2.1
Electrical Machinery and Equipment	1,248	11,436	1,012.0	372.6	1.5
Transmission and distribution equipment	51	1,241	149.5	47.4	1.8
Household appliances	49	592	71.2	25.0	1.9
Communications equipment	130	1,059	135.7	49.0	2.1
Electronic components, etc.	470	4,145	370.1	139.0	1.5
Transportation equipment	401	21,819	1,664.8	582.3	1.2
Motor vehicles and equipment	177	13,016	717.2	254.3	0.9
Aircraft and parts	178	8,243	887.5	303.4	1.7
Prof. and scientific instruments, etc.	420	4,912	550.6	204.0	1.9
Research instruments	95	1,039	108.3	43.5	1.9
Physical measuring instruments	140	973	78.5	30.9	1.5
Surgical, medical, dental, etc.	114	571	57.0	23.9	1.9
Photographic equipment	43	2,157	290.4	100.0	2.1
All other manufactures	525	1,996	156.1	63.8	1.5

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1/ Classification is based on the product or product class accounting for the largest portion of gross receipts.

2/ Statistics on DISC sales of agricultural products exceed U.S. exports from all sources by a substantial margin because of inter-DISC sales. Therefore, the ratio of net income to gross receipts understates the profit margin on exports of these products.

3/ Tax deferred income X 0.46/Gross receipts.

demand is somewhat less elastic than category 2. Products are also more likely to be differentiated, which would also reduce the elasticity of demand. The high technological level reduces the number of countries that may be alternative sources of supply.

4. Resource-related manufacturing products. These include paper, lumber, and nonferrous metals. Production of these products is constrained by the availability of some natural resource in the United States. Products tend to be standardized. This category is therefore close in character to nonmanufactured products in having both very elastic supply and demand conditions.

The particular products in each category are listed in Appendix B. Appendix B also gives the elasticities of demand and supply assumed for each category.

Figure 1 illustrates the analysis in this chapter of the change in exports that would occur if DISC were eliminated. The example depicted is for an export such as an agricultural good with a very high demand elasticity. DD and SS are the current demand and supply schedules respectively. The current level of exports is OX and the price is XA. The elimination of DISC decreases export supply, i.e., shifts the supply of export schedule upwards to S'S' because it reduces the after-tax profit from producing any level of exports. If a price of XA were required, with DISC, to induce producers to produce OX of exports, then without DISC, a price of XB would be needed. But since that price cannot be obtained with the demand represented by DD, OX of exports will not be supplied.

The magnitude of BA, the vertical shift in the supply schedule, depends on the DISC tax saving per dollar of capital devoted to producing exports. Exporters would be willing to continue to supply OX if they could earn the same after-tax profit per unit of such capital. The DISC tax saving per unit of capital is approximated by the reduction in tax on the pre-tax return per unit of capital used. This reduction depends on the percentage of profits that can be deferred and the marginal corporate tax rate, which is assumed to be 46 percent for DISC year 1980.

As a result of the shift in supply resulting from the elimination of DISC, exports fall to OY. More generally, the magnitude of the changes in the quantity of exports depends on the slopes of the demand and supply schedules in each category.

The analysis of the reduction in the value of exports if DISC were eliminated is summarized in Table 3-2. The overall reduction in the value of exports is in the range of $6.2 billion to

Figure 1

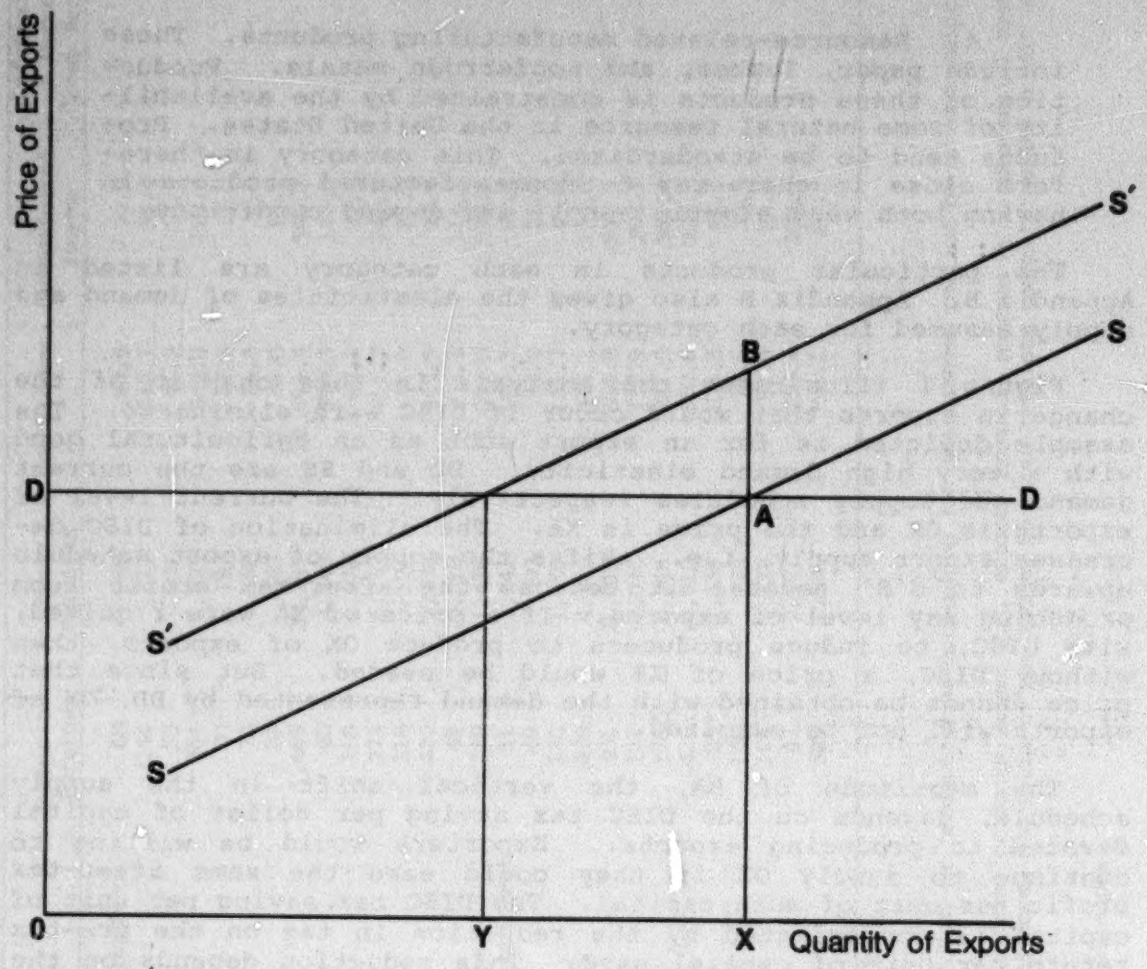

Table 3-2

Estimated Reduction in Exports
if DISC Were Eliminated - DISC Year 1980

Product Category	DISC Saving Per Dollar of Sales (in cents)	Percent Reduction in Value of Exports (range)	Decrease in Dollar value of Exports (billions)
1. Nonmanufactured Products	.3	1.0 - 1.6	.4 - .6
2. Basic Manufactures	1.1	7.9 - 10.3	2.8 - 3.6
3. High Technology Manufactures	1.6	5.3 - 9.7	2.5 - 4.7
4. Resource Related Manufactures	.9	4.1 - 4.5	.5
TOTAL	1.1	4.7 - 7.1	6.2 - 9.4

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$9.4 billion. The relatively modest reduction of exports of non-manufactured products reflects the small DISC-induced shift in export supply. Exports of both basic and high technology manufactured products decline substantially. Although export demand in high technology products is assumed to be somewhat less price sensitive than basic manufactured products, the decline in exports is substantial because the DISC induced shift in export supply is large.

As noted earlier, the $6.2 billion to $9.4 billion increase in exports because of DISC is based on the assumption that the marginal corporate tax rate on DISC income is 46 percent, i.e., a dollar of tax-deferred income will save 46 cents in taxes. Whether this assumption is valid depends upon the degree to which parents employing DISCs have net operating losses or excess tax credits that in the absence of DISC cannot be carried forward.

If a firm has a net operating loss that cannot be carried forward, then there is no net tax saving associated with deferring income through a DISC. Whatever the firm gains in tax saving by deferring income it could have equally gained by offsetting the income against the previous years' net operating loss. Similarly, if the firm has excess investment tax credits that cannot be carried forward, there is no net saving through a DISC since the tax saved by deferring income could have as well been saved by use of the excess tax credits. However, if the firm could have carried forward the net operating loss or excess tax credits, then there is a current net tax saving from deferring income through a DISC. Nevertheless, there is a limitation on the ability to carry forward net operating losses and excess tax credits so that in the year in which this limitation is reached there is once again no net tax saving from deferring income through a DISC. Therefore, the marginal corporate tax rate on DISC income may be significantly less than 46 percent and, correspondingly, the export effect of DISC may be significantly less than the estimated range.

The effect of DISC on exports, described above, is the direct effect before any induced changes in patterns of production and investment. In a departure from previous reports, this report analyses the indirect effect of DISC solely in terms of changes in resource allocation and relative prices. Previous reports have analyzed the second round effect in terms of the impact of a change in U.S. exports on U.S. imports through changes in U.S. exchange rates. Since U.S. exchange rates are the prices of the U.S. dollar in terms of other countries' currencies, these exchange rates are determined by the supply of and demand for the dollar, which is to a large degree a monetary phenomenon. While DISC has an indirect impact on the supply of and demand for the

dollar through the U.S. balance of merchandise trade, international flows of services and capital - both short-term and long-term - have an equal and often more important role in determining U.S. exchange rates. The analysis of the second round effect in this year's report, therefore, focuses on the real economic effects of the DISC legislation.

The change in tax on export profits brought about by DISC causes a shift in U.S. capital and labor toward the production of exports. 3/ These resources may come from either industries selling goods produced only at home or from industries producing goods competing with imports. A shift in resources away from industries producing non-traded goods will tend to increase their price relative to other goods and, thus, diminish their domestic consumption. Furthermore, a shift in resources away from import competing industries will tend to increase the level of imports. Nevertheless, any increase in the level of imports that may occur will be more than offset by the increase in exports brought about by DISC.

In the long run the effects of DISC on U.S. trade and production will depend on the response of saving and investment flows to the change in the overall return to capital brought about by DISC. Since DISC reduces the effective marginal tax rate on income from capital used in production for export, the after-tax rate of return on capital will, in general, rise as the result of DISC. To the degree that domestic and foreign investment flows respond to this increased rate of return on investment, the U.S. capital stock will increase, generating further increases in U.S. production and trade as the result of DISC. Thus, the estimated range of $6.2 billion to $9.4 billion for the effect of DISC on exports should be viewed as only a first round estimate. A more complete estimate taking into account the second round effects would require an analysis based on a dynamic, general equilibrium model of trade and growth, which is not currently available, rather than the partial equilibrium framework employed in this report.

3/ There is some possibility that DISC exports displace non-DISC exports, but this effect is not likely to be significant. The circumstances in which exporters cannot use a DISC are very specific, as noted in Chapter 2. A DISC would not be used if the firm is making an overall loss. Mineral products benefiting from a percentage depletion allowance are excluded, as are those not intended for use outside the U.S. The latter would include goods exported for assembly and then reimported. DISC and non-DISC exports are therefore unlikely to be very close substitutes.

The effect of DISC on U.S. exports will be further modified by the introduction in the Economic Recovery Tax Act of 1981 (ERTA) of the Accelerated Cost Recovery System (ACRS). Without ACRS, DISC creates a differential in favor of exports by reducing the effective marginal corporate tax rate on production for export and, hence, increasing the after-tax return on capital used in export production. Thus, the differential in the after-tax return in favor of exports falls as the result of ACRS. It is this differential which is the key variable in the allocation of capital between production for the domestic market and production for export. ACRS, therefore, reduces the incentive for export production.

The extent to which ACRS narrows the differential between the after-tax return on capital in general and the after-tax return on export production depends, in part, on the pricing method employed. For companies employing the 50-50 pricing method, the effect of ACRS is to reduce the effective tax rate only on the portion of income that is not already deferred under DISC. Under this method, ACRS will, therefore, reduce the relative export incentive of DISC. While the tax benefit of DISC for companies employing the 4 percent pricing method is not a function of taxable income but rather of gross sales, use of the 4 percent method is constrained by the requirement that income may not be allocated to a DISC so as to leave the parent in a loss position. Under ACRS this no-loss constraint will become increasingly binding. Therefore, the effect of ACRS is, in general, to reduce the relative export incentive of DISC.

Chapter 4 - Effect of DISC on Tax Revenues

The revenue cost of DISC in DISC year 1980 was $1,410 million. The revenue cost is estimated by applying the statutory corporate tax rate of 46 percent to the portion of DISC income on which tax is deferred. The tax-deferred income of a DISC is equal to its taxable income less its deemed distributions. Under the original DISC legislation, the principal deemed distribution was 50 percent of adjusted taxable income. 1/ Thus, the ratio of deemed distributions to DISC taxable income was 51 percent in DISC year 1976.

For accounting periods beginning after December 31, 1975, DISCs are subject to the incremental provision introduced by the Tax Reform Act of 1976. For these periods, DISC shareholders are deemed to receive, in place of 50 percent of DISC adjusted taxable income, all adjusted taxable income attributable to base period exports (defined as 67 percent of the average of the export gross receipts of the DISC during calendar years 1972 through 1975), plus 50 percent of the excess of total adjusted taxable income over the amount attributable to base period exports. 2/ As a result of the incremental provision, as well as other kinds of deemed distributions provided by the Tax Reform Act of 1976, the ratio of deemed distributions to DISC taxable income was nearly 70 percent for DISC year 1977 and 71 percent for DISC year 1978. 3/ The deemed distribution rate decreased to 67.6 percent in DISC year 1979 because the base period remained unchanged from 1978, and to 63.6 percent in DISC year 1980 because the base period changed only for taxable years beginning after 1979. Under the Tax Equity and Fiscal Responsibility Act of 1982 the deemed distribution by a DISC to a corporate shareholder is increased from 50 percent to 57.5 percent of taxable income for the taxable years beginning after 1982.

1/ Other deemed distributions were interest derived from producer's loans made by a DISC, certain kinds of capital gains recognized by a DISC, and the amount of foreign investment attributable to producer's loans for the taxable year.

2/ This base period applies to taxable years beginning in 1976 through 1979. Starting with taxable years beginning in 1980, the base period is advanced each year.

3/ Additional deemed distributions which apply to accounting periods beginning after December 31, 1975, are 50 percent of taxable income attributable to sales of military property, income attributable to international boycott activity, and the amount of illegal bribes.

The foregoing revenue estimates assume that the labor and capital producing DISC exports would have the same level of income in the absence of DISC, with the only change being that the full corporate rate would apply to profits. In reality, economic responses may make the true revenue cost different from the $1,410 million estimate. In the absence of DISC, before-tax margins may increase. In that case, the revenue estimate would be understated. On the other hand, there may be responses which reduce the revenue cost of DISC. By reducing the tax on the corporate sector, DISC will increase saving and attract capital from the noncorporate sector. The increased capital stock may lead to higher levels of output, employment, and tax revenue. In the absence of DISC, exporters might have found other ways within existing law to "shelter" export profits. These and other behavorial changes may have an impact on the revenue cost of DISC, but the magnitude of the offset cannot be estimated without more precise information on the adjustment taking place.

The $1,410 million estimated revenue cost for DISC year 1980 is based on the assumption that DISC income would be taxable to the parent at the statutory rate of 46 percent in the year in which earned. The estimate understates the revenue cost of DISC in those cases where the existence of a DISC enables taxation of the deemed distribution to be postponed until the next year. Such cases occur where the end of the DISC's fiscal year is one or two months later than the end of the parent corporation's fiscal year. The estimate, however, overstates the revenue costs of DISC to the degree that the marginal tax rate is less than 46 percent. As discussed in the previous chapter, the effect of net operating losses and excess tax credits is, in general, to reduce the tax saving to companies which export through a DISC. In those cases where net operating losses and excess tax credits cannot be carried forward, there is no tax saving from employing a DISC. Therefore, like the estimates of the export impact of DISC, the estimates of the revenue cost of DISC may be substantial overestimates. But whether or not they are overestimates, the relation between export impact and revenue cost is, as a first approximation, invariant with changes in the marginal tax rate since the impact and cost increase or decrease together in approximate proportion.

Table 4-1 presents the estimated revenue costs of DISC for calendar and fiscal years 1972 through 1979, as well as projected revenue costs for 1980 through 1987. 4/ Adjusting DISC income in DISC year 1980 to a calendar year basis requires apportioning the

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4/ The $1,410 million estimate refers to DISC year 1980, and is therefore to be distinguished from the calendar and fiscal year estimates in Table 4-1.

Table 4-1

Revenue Cost Estimates and Projections,
Actual Tax Rates and DISC Provisions 1/
(Millions of Dollars)

Year	Calendar Year Tax Liability: Cost Under Original Act	Cost Reductions 2/: Incremental Provision	Cost Reductions 2/: Other	Cost Reductions 2/: TEFRA Reduction	Cost Under Present Law 3/	Fiscal Year Receipts Foregone (Present Law) 4/
(1)	(2)	(3)	(4)	(5)	(6)	(7)
1972	$ 350				$ 350	$ 100
1973	730				730	460
1974	1,120				1,120	850
1975	1,160		$ 10		1,150	1,130
1976	1,160	$ 370	40		750	1,020
1977	1,200	450	50		700	720
1978	1,430	440	50		940	830
1979	1,850	440	60		1,350	1,120
1980	2,170	530	70		1,570	1,450
1981	2,270	600	90		1,580	1,570
1982	2,090	630	100		1,360	1,550
1983	2,110	700	120	$ 190	1,110	1,230
1984	2,180	800	130	190	1,060	1,080
1985	2,330	940	160	190	1,040	1,060
1986	2,500	1050	190	190	1,070	1,060
1987	2,690	1120	220	200	1,150	1,110

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1/ The 1972 through 1979 figures are estimated from DISC returns. All other figures are projections. The projections for 1981 and subsequent years take into account the effect on DISC of the Accelerated Cost Recovery System (ACRS) introduced in the Economic Recovery Tax Act of 1981. The projections for 1983 and subsequent years take into account the effect of the Tax Equity and Fiscal Responsibility Act of 1982 on ACRS and the DISC deferral rates. All figures are based on the assumption that in the absence of DISC, the earnings would be subject to tax at the corporate tax rate, which is 48 percent for 1972-78 and 46 percent for 1979 and subsequent years.

2/ Net reduction in revenue costs as a result of changes provided for in the Tax Reduction Act of 1975, the Tax Reform Act of 1976, and the Tax Equity and Fiscal Responsibility Act of 1982 (see Chapter 2 for details).

3/ Column (2) minus the sum of columns (3) (4) and (5).

4/ Calculated on the basis of normal relationships between calendar year corporate tax liabilities and fiscal year receipts. Fiscal years through 1976 end on June 30 of the corresponding calendar year, thereafter on September 30. The transition quarter in 1976 is not shown separately. The receipts estimate for that quarter is $110 million.

income reported on all DISC returns filed for tax years which overlap calendar year 1979. This results in an estimate of DISC revenue cost for calendar year 1979 of $1,350 million. As shown in column 3, the incremental provisions reduced the revenue cost of the original DISC program by 24 percent in calendar year 1979. Tax savings provided by the other amendments to the original DISC program (i.e., reduced benefits for military exports and the exclusion of certain natural resource products from DISC benefits) reduced the revenue cost of the original legislation by an additional 3.2 percent in calendar year 1979.

The projections for DISC year 1981 and subsequent years take into account the effect of ACRS on tax-deferred income. As indicated in the previous chapter, for companies employing the 50-50 pricing method, ACRS will reduce the tax benefit of DISC by reducing the effective, marginal corporate tax rate. For companies employing the 4 percent pricing method the revenue cost estimates of DISC will not be affected by ACRS, since the tax benefit of DISC under this pricing method is not a function of taxable income but rather of gross sales, which are assumed to be unaffected by ACRS. However, under ACRS the ability of firms to use the 4 percent method may be increasingly limited by the requirement that income cannot be allocated to a DISC so as to leave the parent with a loss.

The projections for DISC year 1981 and beyond reflect projections of combined taxable income under ACRS, the current mix of pricing methods employed, and the appropriate deferral rate. For taxable years beginning after 1982, the deferral rate for corporate shareholders of a DISC falls from 50 percent to 42.5 percent. Because of data limitations the projections do not reflect the differences that may exist between the national mix of depreciable assets subject to ACRS and the mix of depreciable assets employed in the generation of exports sales through DISCs. The projections also do not reflect the degree to which companies may shift from the 50-50 method to the 4 percent method to put a floor on the reduction in the relative effectiveness of DISC brought about by ACRS or the degree to which the no-loss requirement may increasingly constrain the use of the 4 percent pricing method. Finally, the projections do not reflect the change in the marginal tax rate on DISC income that may be brought about by ACRS. On the one hand, ACRS will decrease the saving from tax-deferred income by increasing the amounts of net operating losses and excess tax credits through reductions in taxable income. The excess tax credits will be further increased by the enhanced investment tax credit provisions of ERTA. On the other hand, the safe-harbor leasing provisions of ERTA will increase the tax saving from DISC tax-deferred income by decreasing the amounts of net operating losses and excess investment tax credits.

Distribution of DISC Benefits

For corporate owners for which asset size is available, 65.9 percent of the tax-deferred income of the DISCs in DISC year 1980 accrued to the 7.3 percent of the DISCs with parent companies having assets of at least $500 million (see Table 4-2). The 179 DISCs with gross receipts of $100 million or more accounted for 60.2 percent of all tax-deferred DISC income (see Table 4-3). The 126 DISCs with net incomes of $10 million or more accounted for 59.2 percent of all tax-deferred income (see Table 4-4). Ten DISC parents accounted for 26.2 percent of all tax-deferred income and 27.5 percent of all net income. 5/

Data on the distribution of tax-deferred income DISCs owned directly or indirectly by foreign corporations are available only for DISC year 1975. They show that $85 million of DISC dividends -- 4 percent of the total -- were distributed to U.S. corporations with foreign owners; $2 million of DISC dividends -- 0.1 percent of the total -- were distributed directly to foreign corporations.

DISC Elections

A cumulative total of 15,650 elections were made through February 1982 (see Table 4-5). This represents an increase of 1,854 or 13 percent, over February 1981. The data on DISC elections are not adjusted for DISCs that are inactive or that have been liquidated or have withdrawn their elections. 6/ Nevertheless, the growth in election demonstrates the continued interest in the use of the DISC provisions.

5/ The fact that the distribution of tax-deferred income was less concentrated than the distribution of DISC net income reflects the exemption of small DISCs from the incremental provision of the 1976 Tax Reform Act.

6/ For example, for accounting periods ending between July 1, 1979 and June 30, 1980, 7,933 DISC returns were filed even though 10,978 DISC elections had been made as of February 28, 1979. These two figures are chosen for comparison since a DISC election must be made, at the latest, within 90 days after the beginning of the DISC's taxable year, and the largest number of returns are for periods beginning in December 1978 and January 1979. The difference between these two figures reflects primarily the number of inactive DISCs, including newly created DISCs which have not yet begun operation. The number of DISC returns filed during DISC year 1980 increased by 725, or 10.1 percent, which is slightly faster than the growth in elections.

Table 4-2

Gross Receipts, Net Income and Tax-deferred Income by Asset Size of Corporate Majority Shareholder - DISC Year 1980
(Dollar Amounts in Millions)

Asset Size of Corporate Majority Shareholder	Returns		Gross Receipts		Net Income		Tax-deferred Income	
	Number	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
All Returns	7,933	100.0	131,976	100.0	8,426.5	100.0	3,065.9	100.0
No Majority Shareholder or Assets not Available	1,967	24.8	7,432	5.6	255.5	3.0	114.9	3.7
Returns with Majority Corporate Shareholder	5,966	75.2	124,544	94.4	8,171.0	97.0	2,951.0	96.3
			Returns with Majority Corporate Shareholder					
Total	5,966	100.0	124,544	100.0	8,171.0	100.0	2,951.0	100.0
$1 under $100,000	77	1.3	91	0.1	5.8	0.1	2.8	0.1
$100,000 under $1,000,000	665	11.1	612	0.5	35.2	0.4	15.8	0.5
$1,000,000 under $5,000,000	1,811	30.4	3,285	2.6	188.9	2.3	85.2	2.9
$5,000,000 under $10,000,000	765	12.8	3,136	2.5	186.2	2.3	77.5	2.6
$10,000,000 under $50,000,000	1,406	23.6	12,090	9.7	773.9	9.5	305.9	10.4
$50,000,000 under $100,000,000	366	6.1	12,206	9.8	455.1	5.6	167.4	5.7
$100,000,000 under $250,000,000	262	4.4	4,983	4.0	416.2	5.1	149.1	5.1
$250,000,000 under $500,000,000	178	3.0	8,092	6.5	563.1	6.9	203.5	6.9
$500,000,000 under $1,000,000,000	175	2.9	20,112	16.1	939.6	11.5	343.1	11.6
$1,000,000,000 or more	261	4.4	59,937	48.1	4,607.0	56.4	1,601.0	54.3

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* Less than 0.05 percent

Table 4-3

Gross Receipts, Net Income and Tax-deferred Income by Size of Gross Receipts of the DISC - DISC year 1980
(Dollar Amounts in Millions)

Sizes of Gross Receipts	Returns		Gross Receipts		Net Income		Tax-deferred Income	
	Number	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
			All Returns					
Total	7,933	100.0	131,976	100.0	8,426.5	100.0	3,065.9	100.0
Zero Receipts	582	7.3	—	—	55.0	0.7	18.2	0.3
$1 under $50,000	317	4.0	6	*	-0.1	*	0.7	*
$50,000 under $250,000	909	11.5	129	0.1	16.4	0.2	8.2	0.3
$250,000 under $1,000,000	1,735	21.9	973	0.7	104.2	1.2	50.2	1.6
$1,000,000 under $10,000,000	3,193	40.2	10,641	8.1	823.8	9.8	335.0	10.9
$10,000,000 under $100,000,000	1,018	12.8	29,281	22.2	2,215.3	26.3	806.8	26.3
$100,000,000 under $250,000,000	109	1.4	17,500	13.3	1,194.8	14.2	420.1	13.7
$250,000,000 or more	70	0.9	73,446	55.7	4,017.1	47.7	1,426.7	46.5

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* Less than 0.05 percent

Table 4-4

Gross Receipts, Net Income and Tax-deferred Income by Size of Net Income of the DISC - DISC year 1980
(Dollar Amounts in Millions)

Size of Net Income	Returns		Gross Receipts		Net Income		Tax-deferred Income	
	Number	Percent of Total	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Net Income
All returns	7,933	100.0	131,976	100.0	8,426.5	100.0	3,065.9	36.4
Less: Deficit returns	703	8.9	3,388	2.6	-36.8	-0.4	—	—
Returns with zero net income	106	1.3	313	0.2	—	—	—	—
Returns with net income	7,124	89.8	128,275	97.2	8,463.3	100.4	3,065.9	36.4
$1 under $100,000	3,486	43.9	3,919	3.0	133.3	1.6	63.3	47.5
$100,000 under $200,000	1,042	13.1	3,011	2.3	151.0	1.8	66.8	44.2
$200,000 under $1,000,000	1,672	21.1	13,385	10.1	739.3	8.8	289.3	39.1
$1,000,000 under $5,000,000	678	8.5	22,229	1.7	1,468.1	17.4	538.5	36.7
$5,000,000 under $10,000,000	120	1.5	11,419	8.7	821.4	9.7	291.9	35.5
$10,000,000 under $25,000,000	81	1.0	16,893	12.8	1,231.4	14.6	439.8	35.7
$25,000,000 under $50,000,000	24	0.3	7,953	6.0	829.8	9.8	289.8	34.9
$50,000,000 or more	21	0.3	49,465	37.5	3,089.0	36.7	1,086.5	35.2

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Table 4-5

DISC Elections

End of Period	Cumulative Total
1972 - March	1,136
June	2,412
September	3,049
December	3,439
1973 - March	3,842
June	4,164
September	4,466
December	4,825
1974 - March	5,184
June	5,570
September	6,569
December	6,738
1975 - March	7,293
June	7,653
September	7,956
December	8,258
1976 - March	8,522
June	8,805
September	9,070
December	9,331
1977 - February	9,447
June	9,718
September	9,827
December	10,024
1978 - February	10,144
June	10,341
September	10,552
December	10,780
1979 - February	10,978
June	11,285
September	11,667
December	11,924
1980 - February	12,192
June	12,645
September	13,061
December	13,489
1981 - February	13,796
June	14,425
September	14,906
December	15,355
1982 - February	15,650

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Chapter 5 - General Statistical Information

This Report covers the eighth full year of DISC operations. The tabulations are based on a sample of 2,647 tax returns, Form 1120-DISC, filed by active DISCs for taxable periods ending between July 1, 1979, and June 30, 1980. This period is defined as DISC year 1980, although most of the activity it covers occurred in calendar year 1979. 1/ Table 5-1 presents the total number of DISC returns filed for DISC year 1976-80, as well as statistics on DISC receipts, net income, and assets for each of these years.

DISC Income

In DISC year 1980, net income attributable to DISC manufactured exports amounted to $7.7 billion. This figure is 160 percent greater than the amount reported in the second DISC year, 1974, and is 30 percent greater than net income reported in DISC year 1979. Because the 30 percent increase in net income slightly exceeded the 28 percent increase in DISC gross sales of manufactures, DISCs' average profit margin for all manufactured product classes rose from 8.1 to 8.2 percent of sales between DISC years 1979 and 1980. Table 5-2 presents statistics on DISC receipts, net income, and tax-deferred income by accounting period in DISC year 1980. The weighted average of tax-deferred income as a percentage of net income was 36.4 percent.

Table 5-3 presents data on the pricing methods used by DISCs. It shows that 34.8 percent of DISC sales were reported as being subject to the 50-50 pricing method, 34.1 percent to the 4 percent method, and 6.9 percent to the arm's-length pricing method. The remaining 24.2 percent of DISC sales were subject to some combination of these three methods or were shown on returns in which the pricing method could not be determined. This information can be used to estimate the combined profit margins of DISCs

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1/ Because the majority of DISCs have tax years ending in December 1979 or January 1980, roughly 83 percent of the exports reported in DISC year 1980 occurred in calendar year 1979. Consequently, activities in 1979 are major determinants of the results reported for DISC year 1980. DISC year 1980 is equivalent to statistical year 1979 as used by the Internal Revenue Service. See Appendix A for definitions and a description of the sampling procedure.

Table 5-1

Historical Statistics, DISC Years 1977-1980
(Dollar Amounts in Millions)

	1977	1978	1979	1980
Number of Returns, Total	6,911	6,665	7,208	7,933
Full Year	6,421	6,316	6,768	7,354
Part Year	490	349	440	579
Gross Receipts, Total	$82,681	$85,887	99,603	131,976
Nonmanufactured Products	23,997 1/	25,521 1/	26,038 1/	37,867
Manufactured Products	58,684	60,366	73,566	94,109
Export Receipts, Total	82,681	85,887	99,604	131,976
Canada	11,382	n.a.	14,360	n.a.
Latin American Republics	8,334	n.a.	11,691	n.a.
Europe	26,261	n.a.	30,395	n.a.
Japan	7,287	n.a.	8,927	n.a.
U.S. Destinations	4,691	n.a.	4,701	n.a.
All Other and Unallocated	24,726	n.a.	29,530	n.a.
Net Income	5,062	5,211	6,402	8,427
Nonmanufactured Products	421	411	480	728
Manufactured Products	4,651	4,800	5,923	7,699
Tax-deferred Income	1,572	1,519	2,071	3,066
Nonmanufactured Products	145	139	171	284
Manufactured Products	1,427	1,380	1,901	2,782
Total Assets, End of Year	14,678	15,955	19,725	24,161
Trade Receivables	8,840	10,162	12,416	14,897
Other Assets	5,838	5,793	7,309	9,264
Accumulated Income, End of Year	8,527	9,560	11,383	14,146

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1/ Statistics on DISC sales of nonmanufactured products, specifically agricultural products, exceed U.S. exports from all sources by a substantial margin because of inter-DISC sales. Therefore, gross receipts of nonmanufactured products overstate exports of these products.

n.a. — not available

Table 5-2

Gross Receipts, Net Income and Tax-deferred Income by Accounting Period - DISC Year 1980
(Dollar Amounts in Millions)

Accounting Period Ending	Number of Returns	Gross Receipts	Net Income	Tax-deferred Income	Tax-deferred Income as a Percent of Net Income
All Returns	7,933	131,976	8,426.5	3,065.9	36.4
Full Year Returns, All Periods	7,354	129,297	8,353.9	3,025.7	36.2
July 1979	446	3,412	229.1	87.0	38.0
August 1979	317	1,442	90.3	33.2	36.8
September 1979	534	4,156	190.9	71.0	37.2
October 1979	419	5,947	449.8	161.3	35.9
November 1979	343	2,480	201.2	73.8	36.7
December 1979	1,627	35,839	2,538.7	901.0	35.5
January 1980	1,347	33,460	3,111.6	1,117.4	35.9
February 1980	325	6,128	365.5	128.6	35.1
March 1980	549	6,436	303.8	114.0	37.6
April 1980	432	4,162	266.0	100.8	37.6
May 1980	347	13,964	295.5	118.2	39.9
June 1980	668	11,871	311.5	119.5	38.4
Part Year Returns, All Periods	579	2,679	72.6	40.2	55.4

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Table 5-3

Gross Receipts, Net Income and Tax-deferred Income by Pricing Method - DISC Year 1980
(Dollar Amounts in Millions)

Pricing Method	Number of Returns	Gross Receipts	Net Income		Tax-deferred Income
			Amount	Percent of Gross Receipts	
All products					
All returns	7,933	131,976	8,426.5	6.4	3,065.9
Returns reporting pricing method	6,467	125,499	8,143.8	6.5	2,949.6
50-50 method	3,246	45,904	4,787.7	10.4	1,765.9
4 percent method	1,727	45,045	1,096.3	2.4	399.2
Arm's-length method	1,041	9,119	478.6	5.2	182.5
50-50 and 4 percent	429	23,635	1,711.9	7.2	575.3
All other combinations	24	1,796	69.3	3.8	26.9
Pricing method not determinable	1,466	6,476	282.7	4.4	116.3
Nonmanufactured products					
All returns	953	37,867	728.1	1.9	284.4
Returns reporting pricing method	525	35,314	684.6	1.9	263.6
50-50 method	172	1,292	114.5	8.8	44.3
4 percent method	189	27,660	465.8	1.7	174.2
Arm's-length method	135	3,703	24.3	0.6	13.4
All combinations	29	2,660	80.1	3.0	31.8
Pricing method not determinable	428	2,553	43.5	1.7	20.8
Manufactured products					
All returns	6,980	94,109	7,698.4	8.2	2,781.5
Returns reporting pricing method	5,942	90,185	7,459.2	8.3	2,686.1
50-50 method	3,074	44,613	4,673.2	10.5	2,686.1
4 percent method	906	17,385	630.5	3.6	1,721.6
Arm's-length method	424	5,416	454.3	8.4	224.9
All combinations	1,036	22,771	1,701.1	7.5	570.3
Pricing method not determinable	1,038	3,924	245.4	6.2	95.5

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and their related suppliers. The average value of this combined margin for all manufactured exports sold through DISCs was 13.9 percent of gross sales in DISC year 1980. 2/

Balance Sheet Statistics

Table 5-4 presents year-end balance sheet statistics. Total assets of DISCs amounted to $24.1 billion, 22.3 percent higher than the previous year's figure. Of these assets, 61 percent consisted of trade receivables (accounts and notes receivable). The second largest asset item was producer's loans, which were 15 percent higher than in DISC year 1979. The category "other assets" increased by 52 percent between the DISC years 1979 and 1980, after increasing 42 percent the previous year. The fastest growing category was export property, which grew 76 percent.

On the liabilities and capital side in the lower part of Table 5-4, the largest item was accumulated DISC income, amounting to $20.0 billion, 83 percent of the value of liabilities and stockholders' equity. The amount of accumulated DISC income was approximately equal to the difference between total reported DISC earnings of $39.3 billion through DISC year 1980, and total reported actual DISC distributions of $17.5 billion. 3/ Total actual DISC distributions through DISC year 1980 were $7.1 billion less than the amount deemed to have been distributed--and taxed--to shareholders. Retention of tax-paid earnings by DISCs presumably reflects the financial incentives involved, notably the favorable tax treatment of interest earned on qualified export receivables and other investments.

Income Statement Statistics 4/

Table 5-5 presents combined income statement statistics for all DISCs. While almost all of the qualified receipts of $43.6 billion consisted of receipts from the sale of export property,

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2/ Statistics for DISC exports of nonmanufactured products, specifically agricultural products, are overstated relative to actual exports because of inter-DISC sales. Thus, the ratio between DISC net income and gross receipts for agricultural products does not represent the true rate of return on DISC exports of these products. For an explanation of the derivation of the combined profit margins, see pages 35-36 of the 1976 Report.

3/ The difference between accumulated DISC income and total earnings less actual distributions is due to statistical and reporting errors.

4/ Note that, for income statement purposes, receipts include only the commissions in the case of goods sold on a commission basis.

Table 5-4

Balance Sheet Statistics - DISC year 1980
(Millions of Dollars)

	All Products
Total assets	24,161
Qualified assets, total	24,105
Working capital	475
Export-Import Bank obligations	1,211
Trade receivables	14,897
Export property	1,588
Producer's loans	3,484
Other	2,450
Nonqualified assets	56
Total liabilities and capital	24,161
Liabilities, total	3,902
Accounts payable	2,340
Other current liabilities	969
Mortgages, notes, bonds payable in one year or more	213
Other liabilities	380
Capital accounts, total	20,259
Capital stock and paid-in surplus	253
Previously taxed income	5,860
Tax-deferred income	14,146

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Table 5-5

Income Statement Statistics - DISC year 1980
(Millions of dollars)

	Number of Returns	Amount (Millions)
Total receipts 1/	7,538	43,575
Qualified export receipts, total	7,498	43,408
Qualified receipts from property sales	7,175	42,180
Other qualified receipts, total	3,881	1,228
Leasing of export property	69	49
Services related to qualified exports	286	63
Engineering and architectural services	101	100
Qualified dividends	37	27
Interest on producer's loans	1,684	245
Other interest	2,324	730
Other qualified receipts	n.a.	14
Nonqualified receipts, total 2/	1,077	193
Total deductions	6,688	35,175
Cost of sales and operations	3,628	32,920
Export promotion expenses	3,613	1,238
Other expenses	5,986	1,017
Total receipts less total deductions	7,119	8,400
Net income	7,827	8,426
Tax deferred and taxable income	7,102	8,461
Total deemed distributions	7,013	5,397
Attributable to base period export gross receipts	2,485	1,934
All other deemed distributions	n.a.	3,463
Actual distributions	1,414	4,144

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1/ For income statement purposes receipts include only the commission earned on commission sales.

2/ Net of adjustments to income.

n.a. -- Not available.

$1.2 billion constituted receipts from other sources. The largest item in this latter category was interest income amounting to almost $730 million.

As would be expected, the largest deduction was the $32.9 billion for cost of goods sold and cost of operations. The only other significant deduction was for export promotion expenses, amounting to just over $1.2 billion or one percent of the value of total DISC exports.

Audit Results

Substantial adjustments in DISC income were proposed in calendar year 1981 as a result of audit examinations. In total, DISC income was reduced by $617.3 million and the income of parents was increased by the same amount. Tax liabilities increased by about $55 million. Most of the proposed adjustments were for the years from 1976 to 1979. More than 74 percent of the reduction of DISC income was due to intercompany pricing adjustments. Apparently these were largely the result of the failure of parents and their DISCs to have explicit written agreements on their exact pricing rules. The only other significant reason for proposed adjustments to DISC income was the disallowance of DISC status because the corporation did not meet the 95 percent export assets test in section 993 of the Internal Revenue Code.

Appendix A -- Definitions and Sampling Procedure

Definitions

Unless otherwise indicated, the following definitions apply throughout this Report.

1. DISC gross receipts. Gross receipts of a DISC include the full value of goods and services sold on a commission basis. This item is reported on Schedule N, Part I, Section A, Column 2 of Form 1120-DISC. 1/

2. DISC net income. Net income of a DISC is gross receipts less costs and less deductions. It is reported on line 10 of page 1, Form 1120-DISC. Net income may be positive or negative. Of 7,933 DISC returns filed for DISC year 1980, only 703 showed net losses (i.e., negative net income).

3. DISC taxable income. Taxable income of a DISC is net income less net operating loss deduction and dividends-received deduction. It is reported on line 12 of page 1, Form 1120-DISC.

4. Tax-deferred income. The tax-deferred income of a DISC is the part of its taxable income which may be retained tax deferred by the DISC. It equals its taxable income less deemed distributions. For taxable years beginning before January 1, 1976, deemed distributions were the sum of (1) interest on producer's loans, (2) certain capital gains, (3) one half of the excess of taxable income over the sum of (1) and (2), and (4) foreign investment attributable to producer's loans for the taxable year. The Tax Reform Act of 1976 added several new types of deemed distributions and modified (3) above to conform. For taxable years beginning after December 31, 1975, deemed distributions were the sum of (1) adjusted taxable income attributable to base period export gross receipts; (2) interest on producer's loans; (3) certain capital gains; (4) one half of taxable income attributable to military sales; (5) one half of the excess of taxable income over the sum of (1), (2), (3), and (4); (6) income attributable to international boycott activity; (7) the amount of illegal bribes; and (8) foreign investment attributable to producer's loans for the taxable year. Total deemed distributions are reported on Schedule J, Part 1, line 17 of Form 1120-DISC.

5. DISC year 1980. This is defined to cover accounting periods ended July 1, 1979, through June 30, 1980. DISC year 1980 corresponds to SOI year 1979 in the Internal Revenue Service publications on the Statistics of Income.

1/ All references to Form 1120-DISC are to the 1979 form, which appears in Appendix D.

Sampling Procedure

The statistical estimates presented in this Report are based on a stratified random sample of DISC returns. All DISCs with net income of $1 million or more or with parent corporations having assets of $250 million or more were included in the sample (sampling rate of 100 percent). DISCs with less than $200,000 of net income and with parent corporations having assets of less than $50 million whose returns were received prior to January 1980 were sampled at a 10 percent rate and those with returns received after December 1979 were sampled at a 20 percent rate. The remaining DISCs were sampled at a 40 percent rate. DISCs owned by individuals or partnerships were sampled only according to the amount of their net income. A full description of the sampling procedure, together with additional information from DISC returns for the SOI year 1979, will appear in the forthcoming publication, Statistics of Income-1979 Corporation Income Tax Returns.

Table A-1

Summary of Sampling Results

	Number of Returns	Gross Receipts ($ Millions)	Net Income ($ Millions)
All returns	7,933	131,976	8,426.5
Returns sampled at 100%	1,122	114,688	7,488.1
Returns sampled at less than 100%	6,811	17,288	938.4
Addendum			
Unweighted amounts for returns sampled at less than 100%	1,525	5,139	641.1

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APPENDIX B: Information Used to Estimate DISC Effect

Table B-1

Elasticities of Export Demand and Supply
Assumed in Each Major Category

Products Category	Supply Elasticity	Demand Elasticity (absolute value)
1. Nonmanufactured Products	1.5-2.5	Infinite
2. Basic Manufactures	20	6-8
3. High Technology Manufactures	20	3-5
4. Resource Related Manufactures	4	8-10

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Table B-2

Specific Products in Each Major Category

1. All Nonmanufactured Products

2. Basic Manufactured Products

   Textile mill products
   Apparel
   Furniture and fixtures
   Printing and publishing
   Rubber and miscellaneous plastic products
   Leather and leather products
   Stone, clay, glass and concrete products
   Iron and steel industries
   Fabricated metal products
   Machinery except electrical, other than office machinery, engines and turbines, and special industry machinery
   Transportation equipment except aircraft
   All other manufactures

3. High Technology Manufactures

   Ordnance
   Chemicals and allied products
   Engines and turbines
   Special industry machinery
   Office machinery
   Electrical machinery and equipment
   Aircraft and parts
   Professional and scientific instruments, etc.

4. Resource Related Manufactures

   Food and kindred products
   Tobacco manufactures
   Paper and allied products
   Lumber
   Primary metal industries except iron and steel industries

Form **1120-DISC**
Department of the Treasury
Internal Revenue Service

Domestic International Sales Corporation Return

(PLEASE TYPE OR PRINT)

1979

For calendar year 1979 or other taxable year beginning , 1979, ending , 19

A Date of DISC election	Name	C Employer identification number
	Number and street	D Date incorporated
B Business code number (See page 8 of instructions)	City or town, State, and ZIP code	E Enter total assets from line 3, column (B), Schedule L (see instruction L) $

F Did any corporation, individual, partnership, trust or estate at the end of your taxable year own, directly or indirectly, 50% or more of your voting stock? . . . . . Yes ☐ No ☐

If "Yes," enter below the owner's name, address, identifying number, percentage of voting stock owned and, if a corporation, total assets. (See General Instruction Q)

Name	Identifying number	Address	Percentage of voting stock owned	Total assets (Corporations only)	Foreign owner Yes	Foreign owner No

G Indicate by placing an "X" in the appropriate box(es) the inter-company pricing rule or rules which were applied to 25% or more of total receipts (line 4, page 1).
☐ 50–50 combined taxable income method, ☐ 4% gross receipts method, ☐ Section 482 method ("arm's length pricing")

All Computations Must Reflect Inter-Company Pricing Rules Under Section 994 If Used (See Schedule P (Form 1120–DISC))

Gross Income

1	Qualified export receipts from the sale of export property (line 1(c), column E, Schedule B)	
2	Other qualified export receipts: (line 2(j), column E, Schedule B)	
3	Nonqualified gross receipts: (line 3(g), column E, Schedule B)	
4	Total (add lines 1, 2, and 3)	
5	Cost of goods sold (line 7, Schedule A) and/or operations (attach schedule)	
6	Total income (subtract line 5 from line 4)	

Deductions

7	Export promotion expenses: (line 1(o), Schedule E)	
8	Other expenses not deducted above: (line 2(h), Schedule E)	
9	Total deductions (add lines 7 and 8)	

Computation of Taxable Income

10	Taxable income before net operating loss deduction and dividends-received deduction (subtract line 9 from line 6)		
11	(a) Net operating loss deduction (see instructions—attach schedule)		
	(b) Dividends-received deduction (line 2, Schedule I)		
12	Taxable income (subtract line 11 from line 10)		
13	Refund of U.S. tax on special fuels and oils (attach Form 4136)		

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Signature of officer — Date — ▶ Title

Paid Preparer's Information

Preparer's signature and date ▶ — Check if self-employed ▶ ☐ — Preparer's social security no.

Firm's name (or yours, if self-employed) and address ▶ — E.I. No. ▶ — ZIP code ▶

Schedule A — Cost of Goods Sold (See instructions for Schedule A)

Reflect ACTUAL purchases from a related supplier at the transfer price determined under the inter-company pricing rules of section 994, if used. See Schedule P (Form 1120-DISC).

1	Inventory at the beginning of the year	
2	Purchases	
3	Salaries and wages	
4	Other costs (attach schedule)	
5	Total (add lines 1 through 4)	
6	Inventory at the end of the year	
7	Cost of goods sold (subtract line 6 from line 5)—Enter here and on line 5, page 1	

8 (a) Check all methods used for valuing closing inventory:

☐ Cost ☐ Lower of cost or market as described in regulations section 1.471-4 (see instructions)

☐ Writedown of "subnormal" goods as described in regulations section 1.471-2(c) (see instructions)

(b) Did you use any other method of inventory valuation not described above? ☐ Yes ☐ No

If "Yes," specify method used and attach explanation ▶

(c) Check if this is the first year LIFO inventory method was adopted and used ☐

If checked, attach Form 970.

(d) If the LIFO inventory method was used for this taxable year, enter percentage (or amounts) of closing inventory computed under LIFO

(e) Was there any substantial change in determining quantities, cost, or valuations between opening and closing inventory? ☐ Yes ☐ No

If "Yes," attach explanation.

Schedule B — Gross Income (See instructions for Schedule B)

A. Type of receipt	Commission sales B. Gross receipts	Commission sales C. Commission	D. Other receipts	E. Total (add columns C and D)
1 Qualified export receipts from the sale of export property:				
(a) To unrelated purchasers:				
(i) Direct foreign sales				
(ii) Foreign sales through a related foreign entity				
(iii) To persons in the U.S. (other than an unrelated DISC)				
(iv) To an unrelated DISC				
(b) To related purchasers:				
(i) Direct foreign sales				
(ii) To persons in the U.S.				
(c) Total—Enter amount in column E on line 1, page 1				
2 Other qualified export receipts:				
(a) Leasing or renting of export property				
(b) Services related and subsidiary to a qualified export sale or lease				
(c) Engineering and architectural services				
(d) Export management services				
(e) Qualified dividends (line 10, Schedule C)				
(f) Interest on producer's loans				
(g) Other interest (attach schedule)				
(h) Capital gain net income (Attach Schedule D (Form 1120))				
(i) Ordinary gain or (loss) from Part II, Form 4797 (attach Form 4797, see instructions)				
(j) Total—Enter amount in column E on line 2, page 1				
3 Nonqualified gross receipts:				
(a) Ultimate use in U.S.				
(b) Exports subsidized by the U.S. Government (see instructions)				
(c) Certain direct or indirect sales or leases for use by the U.S. Government				
(d) Sales to other DISCs in the same controlled group				
(e) Nonqualified dividends (line 11, Schedule C)				
(f) Other (see instructions—attach schedule)				
(g) Total—Enter amount in column E on line 3, page 1				
4 Total—Enter amount in column E on line 4, page 1				

Schedule C Dividends (See instructions for Schedule C)

1 Domestic corporations subject to the 85% deduction	
2 Certain preferred stock of public utilities	
3 Foreign corporations subject to the 85% deduction	
4 Dividends from wholly-owned foreign subsidiaries subject to the 100% deduction (section 245(b))	
5 Other dividends from foreign corporations	
6 Includable income from controlled foreign corporations under subpart F (attach Forms 3646)	
7 Taxable dividends from a DISC or former DISC not included in line 1 (section 246(d))	
8 Other dividends	
9 Total (add lines 1 through 8)	
10 Qualified dividends—Enter the qualified dividends here and on line 2(e), column D, Schedule B	
11 Nonqualified dividends (subtract line 10 from line 9)—Enter here and on line 3(e), column D, Schedule B	

Schedule E Deductions (See instructions for Schedule E)

1 Export promotion expenses:	
(a) Market studies	
(b) Advertising	
(c) Depreciation (attach Form 4562)	
(d) Salaries and wages	
(e) Rents	
(f) Sales commissions	
(g) Warehousing	
(h) Freight (excluding insurance—see instructions)	
(i) Compensation of officers	
(j) Repairs (see instructions)	
(k) Amortization (attach schedule)	
(l) Pension, profit-sharing, etc. plans (see instructions) (enter number of plans ▶)	
(m) Employee benefit programs	
(n) Other (list):	
(o) Total (add lines 1(a) through 1(n))—Enter here and on line 7, page 1	
2 Other expenses not deducted above:	
(a) Bad debts (Schedule F if reserve method is used)	
(b) Taxes	
(c) Interest	
(d) Contributions (not over 5% of line 12, page 1 adjusted per instructions—attach schedule)	
(e) Freight	
(f) Freight insurance	
(g) Other (attach schedule)	
(h) Total (add lines 2(a) through 2(g))—Enter here and on line 8, page 1	

Schedule F Bad Debts—Reserve Method

1. Year	2. Trade notes and accounts receivable outstanding at the end of the year	3. Sales on account	Amount added to the reserve: 4. Current year's provision	Amount added to the reserve: 5. Recoveries	6. Amount charged against the reserve	7. Reserve for bad debts at the end of the year
1974						
1975						
1976						
1977						
1978						
1979						

Schedule I Dividends-received Deduction (See instructions for Schedule I)

1 (a) 85% of line 1, Schedule C	
(b) 59.13% of line 2, Schedule C	
(c) 85% of line 3, Schedule C	
(d) 100% of line 4, Schedule C	
2 Total—See instructions for limitation. Enter here and on line 11(b), page 1	

Schedule J Deemed and Actual Distributions to Shareholders for the Taxable Year (See instructions for Schedule J)

PART I.—Deemed Distributions Under Section 995(b)(1)

1	Gross interest derived during the year from producer's loans (section 995(b)(1)(A))	
2	Gain recognized on the sale or exchange of property (section 995(b)(1)(B)) (see instructions—attach schedule)	
3	Gain recognized on the sale or exchange of property (section 995(b)(1)(C)) (see instructions—attach schedule)	
4	50% of taxable income attributable to military property (section 995(b)(1)(D)) (see instructions—attach schedule)	
5	Total (add lines 1 through 4)	
6	Taxable income (line 12, page 1)	
7	Adjusted taxable income (subtract line 5 from line 6) (enter here and on line 1, Part II)	
8	Taxable income attributable to base period export gross receipts (section 995(b)(1)(E)) (from line 22, Part II)	
9	Subtract line 8 from line 7 (enter zero if less than zero)	
10	50% of line 9 (section 995(b)(1)(F)(i))	
11	International boycott income (section 995(b)(1)(F)(ii)) (see instructions)	
12	Amount of illegal bribes and other payments (section 995(b)(1)(F)(iii)) (see instructions)	
13	Total of lines 5, 8, 10, 11, and 12	
14	Earnings and profits for year (see instructions—attach schedule)	
15	Enter the smaller of line 13 or line 14 (but not less than zero)	
16	Foreign investment attributable to producer's loans (section 995(b)(1)(G)) (see instructions—attach schedule)	
17	Total deemed distributions under section 995(b)(1) (add lines 15 and 16)	

PART II.—Computation of Taxable Income Attributable to Base Period Export Gross Receipts

1	Adjusted taxable income (from line 7, Part I)	
2	Enter the larger of (a) 365 divided by the number of days in your taxable year or (b) 1 (one)	
3	Annualized adjusted taxable income (line 1 times line 2)	
4	Annualized adjusted taxable income of all other DISCs in your controlled group (see instructions for exceptions)	
5	Line 3 plus line 4 (if $100,000 or less see instructions)	

6 Taxable years beginning in 1972, 1973, 1974, and 1975 (use a separate line for each full or part year, starting with the earliest):

	A. Beginning of year (month, day, year)	B. End of year (month, day, year)	C. Qualified export receipts as described in Sections 993(a)(1)(A), (B), (C), (G), and (H) (see instructions for certain exclusions)	D. 50 percent of qualified export receipts in column C attributable to military property
(a)				
(b)				
(c)				
(d)				
(e)				
(f)	Totals (add lines (a) through (e))			

(g) Base period export gross receipts (subtract Column 6D, line (f) from Column 6C, line (f))

7	Enter the smaller of (a) 1,461 divided by the number of days in your base period or (b) 1 (one)	
8	Line 6(g) times line 7	
9	Adjustment factor	.1675
10	Adjusted base period export gross receipts (line 8 times line 9)	
11	Additions to adjusted base period export gross receipts:	
	(a) Adjusted base period export gross receipts of all other DISCs in your controlled group	
	(b) Other additions (attach schedule—see instructions)	
	(c) Total additions (line 11(a) plus line 11(b))	
12	Line 10 plus line 11(c)	
13	(a) Qualified export receipts as described in sections 993(a)(1)(A), (B), (C), (G), and (H). (Add the amounts from Schedule B, Columns B and D, lines 1(c), 2(a), 2(b), 2(c), and 2(d))	
	(b) 50 percent of qualified export receipts on line 13(a) attributable to military property	
	(c) Export gross receipts (subtract line 13(b) from line 13(a))	
14	Annualized export gross receipts (line 2 times line 13(c))	
15	Annualized export gross receipts of all other DISCs in your controlled group	
16	Line 14 plus line 15	
17	Enter the smaller of (a) line 12 divided by line 16 or (b) 1 (one)	
18	Line 5 times line 17	
19	Small DISC phaseout:	
	(a) Enter the greater of (a) $150,000 less line 5 (but not more than $50,000) or (b) zero	
	(b) Line 19(a) times 2 (two)	
20	Subtract line 19(b) from line 18 (enter zero if less than zero)	
21	Line 1 divided by line 5	
22	Taxable income attributable to base period export gross receipts (line 20 times line 21) (enter here and on line 8, Part I)	

PART III.—Deemed Distributions Under Section 995(b)(2)

1 Annual installment of distribution attributable to revocation of election in a prior year	
2 Annual installment of distribution attributable to a failure to qualify as a DISC in a prior year	
3 Total deemed distributions under section 995(b)(2) (add line 1 and line 2)	

PART IV.—Actual Distributions

1 Distributions to meet qualification requirements under section 992(c) (attach computation)		
2 Other actual distributions		
3 Total of line 1 and line 2		
4 Amount on line 3 treated as distributed out of:		
(a) Previously taxed income		
(b) Accumulated DISC income (including DISC income of the current year)		
(c) Other earnings and profits		
(d) Other		

Schedule K **Shareholder's Statement of DISC Distribution**
(Attach a separate Copy A, Schedule K (Form 1120-DISC) for each shareholder receiving a deemed or actual distribution. Give Copy B to the shareholder. See instructions on the back of Copy C.)

Additional Information Required	Yes	No
H Did you claim a deduction for expenses connected with:		
(1) Entertainment facility (boat, resort, ranch, etc.)?		
(2) Living accommodations (except employees on business)?		
(3) Employees attending conventions or meetings outside the U.S. or its possessions?		
(4) Employees' families at conventions or meetings?		
If "Yes," were any of these conventions or meetings outside the United States or its possessions?		
(5) Employee or family vacations not reported on Form W-2?		
I Enter total amount claimed on Form 1120-DISC for entertainment, entertainment facilities, gifts, travel, and conventions of the type for which substantiation is required under section 274(d) of the Internal Revenue Code. (See instruction S.) ▶ $		
J Refer to page 8 of the instructions and state the principal:		
Business activity ▶		
Product or service ▶		
K Were you a U.S. shareholder of any controlled foreign corporation? (See sections 951 and 957.) If "Yes," attach Form 3646 (and Form 2952 where appropriate) for each corporation.		
L Did you file all required Forms 1087, 1096, and 1099?		
M (1) Did 95% or more of your gross receipts for the taxable year consist of qualified export receipts (as defined in section 993(a))?		
(2) Did the adjusted basis of your qualified export assets (as defined in section 993(b)) at the close of the taxable year equal or exceed 95% of the sum of the adjusted basis of all your assets at the close of the taxable year?		
(3) If the answer to (1) or (2) is "No," did you make a pro rata distribution of property as defined in section 992(c)?		
N (1) Did you have more than one class of stock at any time during the taxable year?		
(2) Was the par or stated value of your stock at least $2,500 on each day (for a new corporation, on the last day for making an election and for each succeeding day) of the taxable year?		
O Are you a member of a controlled group that includes other DISCs?		
If "Yes," (1) Report in Part II, Section B of Schedule N the names, addresses, and employer identification numbers of the DISCs. (2) State the name and employer identification number of the DISC in your controlled group completing C... ...s 3 and 4 of Part I, Sections A and B of Schedule N. See specific instruction B, Schedule N (Form 1120-DISC).		
Name ▶		
Employer identification number ▶		
P Did you have your own bank account?		
Q Did you maintain separate books and records?		
R Did you, at any time during the taxable year, have an interest in or signature or other authority over a bank account, securities account, or other financial account in a foreign country?		
If "Yes," see instruction R.		
S Were you the grantor of, or transferor to, a foreign trust which existed during the current taxable year, whether or not you have any beneficial interest in it?		
If "Yes," you may be required to file Forms 3520, 3520-A, or 926.		
T During the tax year was any part of your tax accounting records maintained on a computerized system?		

Schedule L Balance Sheets

		(A) Beginning of the taxable year	(B) End of the taxable year
Assets	1 Qualified assets:		
	(a) Working capital (cash and necessary temporary investments)		
	(b) Funds awaiting investment (cash in U.S. banks in excess of working capital needs to acquire other qualified export assets)		
	(c) Export-Import Bank obligations		
	(d) Trade receivables (accounts and notes receivable)		
	(i) Subtract allowance for bad debts	( )	( )
	(e) Export property (net) (including inventory and qualified property held for lease)		
	(f) Producer's loans		
	(g) Investment in related foreign export corporations		
	(h) Depreciable assets		
	(i) Subtract accumulated depreciation	( )	( )
	(j) Other (attach schedule)		
	2 Nonqualified assets (net) (list):		
	3 Total assets		
Liabilities and Stockholders' Equity	4 Accounts payable		
	5 Other current liabilities (attach schedule)		
	6 Mortgages, notes, bonds payable in 1 year or more		
	7 Other liabilities (attach schedule)		
	8 Capital stock		
	9 Paid-in or capital surplus		
	10 Other earnings and profits		
	11 Previously taxed income (sec. 996(f)(2))		
	12 Accumulated DISC income		
	13 Less cost of treasury stock	( )	( )
	14 Total liabilities and stockholders' equity		

Schedule M-1 Reconciliation of Income per Books With Income per Return

1 Net income per books		6 Income recorded on books this year not included in this return (itemize)	
2 Excess of capital losses over capital gains			
3 Taxable income not recorded on books this year (itemize)		7 Deductions in this return not charged against book income this year (itemize)	
4 Expenses recorded on books this year not deducted in this return (itemize)			
5 Total of lines 1 through 4		8 Total of lines 6 and 7	
		9 Income (line 10, page 1) (line 5 less line 8)	

Schedule M-2 Analysis of Other Earnings and Profits (Line 10 above)

1 Balance at the beginning of the year		5 Distributions to qualify under sec. 992(c)	
2 Increases (itemize)		6 Other decreases (itemize)	
3 Total of lines 1 and 2		7 Total of lines 4, 5, and 6	
4 Deficit in earnings and profits		8 Balance at end of year (line 3 less line 7)	

Schedule M-3 Analysis of Previously Taxed Income (Line 11 above)

1 Balance at the beginning of the year		5 Deficit in earnings and profits	
2 Deemed distributions under section 995(b)		6 Distributions to qualify under sec. 992(c)	
3 Other increases (itemize)		7 Other decreases (itemize)	
4 Total of lines 1, 2, and 3		8 Total of lines 5, 6, and 7	
		9 Balance at end of year (line 4 less line 8)	

Schedule M-4 Analysis of Accumulated DISC Income (Line 12 above)

1 Balance at the beginning of the year		6 Distributions to qualify under sec. 992(c)	
2 Increases (itemize)		7 Distributions upon disqualification (sec. 995(b)(2))	
3 Total of lines 1 and 2		8 Other decreases (itemize)	
4 Deficit in earnings and profits		9 Total of lines 4 through 8	
5 Redemptions under section 996(d)		10 Balance at end of year (line 3 less line 9)	

Schedule N Export Gross Receipts of the DISC and Related U.S. Persons (Attach separate Schedule N (Form 1120-DISC))

Schedule P Computation of Inter-company Transfer Price or Commission (Attach separate Schedule P (Form 1120-DISC))

1979 Department of the Treasury Internal Revenue Service

Instructions for Form 1120-DISC Domestic International Sales Corporation Return

(References are to the Internal Revenue Code)

Sec. 992. Requirements of a DISC

(a). General rule.—A DISC is a corporation that is incorporated under the laws of any State or the District of Columbia and satisfies the following conditions for the taxable year:

(1) 95% or more of its gross receipts (as defined in section 993(f)) consists of qualified export receipts (as defined in section 993(a));

(2) the adjusted basis of its qualified export assets (as defined in section 993(b)) at the end of the taxable year equals or exceeds 95% of the sum of the adjusted basis of all its assets at the end of the taxable year;

(3) it does not have more than one class of stock and the par or stated value of its outstanding stock is at least $2,500 on each day (for a new corporation, on the last day for making an election and for each succeeding day) of the taxable year;

(4) it has made an election to be treated as a DISC and the election is in effect for the taxable year;

(5) it has its own bank account on each day of the taxable year (for exceptions, see section 1.992–1(i) of the regulations) and maintains separate books and records; and

(6) it is not an ineligible corporation.

(b). Election.—An election by an existing corporation to be treated as a DISC for a taxable year must be made at any time during the 90-day period immediately preceding the beginning of the taxable year and by a new corporation within 90 days after the beginning of the first taxable year.

In general, the election will be valid only if all persons who are shareholders in the corporation on the first day of the first taxable year for which the election is effective consent to the election. (See Form 4876, Election to be Treated as a DISC.)

An election may be terminated by a revocation of the election for any taxable year after the first taxable year for which the election is effective if made at any time during the first 90 days of the taxable year (or for the taxable year following the taxable year in which made, if made after the close of such 90 days).

The election will be terminated by the continued failure of the corporation to be a DISC for each of any 5 consecutive taxable years for which an election is effective.

(c). Distributions to meet qualification requirements.—A corporation that for a taxable year does not satisfy the gross receipts or qualified export assets conditions will be deemed to satisfy the conditions for the taxable year if it makes a pro rata distribution of property after the close of the taxable year to its shareholders (designated at the time of the distribution as a distribution to meet qualification requirements) with respect to their stock in an amount which is equal to (1) the portion of its taxable income attributable to its gross receipts that are not qualified export receipts if it fails the gross receipts condition, (2) the fair market value of those assets that are not qualified export assets on the last day of the taxable year if the qualified export assets condition is not met, and (3) the sum of (1) and (2) if neither condition is met.

See section 992(c)(2) for reasonable cause for failure to make distributions to meet qualification requirements and section 992(c)(3) for distributions made within 8½ months after the close of the taxable year.

For computation of deficiency distributions to meet qualification requirements, see section 1.992–3 of the regulations.

A DISC that makes a deficiency distribution after the 15th day of the ninth month following the close of its taxable year must pay an "interest" charge for the amount to qualify as a deficiency distribution. The "interest" charge is 4½% per each taxable year of the DISC beginning after the taxable year to which the deficiency distribution relates until the date of the distribution times the amount of the deficiency distribution.

The DISC must pay this "interest" charge within 30 days of the distribution to the Internal Revenue Service Center where it filed its Form 1120–DISC. When submitting payment, the DISC should give its name, address, employer identification number, the taxable year to which the distribution relates, and state that the amount submitted is the "interest" charge imposed by regulation section 1.992–3(c)(4).

(d). Ineligible corporations.—The following corporations are not eligible for DISC treatment:

(1) a corporation exempt from tax under section 501,

(2) a personal holding company as defined in section 542,

(3) a financial institution to which section 581 or 593 applies,

(4) an insurance company subject to the tax imposed by subchapter L,

(5) a regulated investment company as defined in section 851(a), or

(6) an electing small business corporation as defined in section 1371(b).

(e) Restrictions on DISCs and DISC corporate stockholders.—For any taxable year in which a corporation is a DISC or in which at any time it owns, directly or indirectly, stock in a DISC or former DISC, such corporation is not allowed to take the Western Hemisphere Trade Corporation deduction (section 922), and is not entitled to the benefits of section 936.

Sec. 993. Definitions

(a). Qualified export receipts.—Except as provided by regulations under section 993(a)(2), qualified export receipts of a corporation are:

(1) gross receipts from the sale, exchange, or other disposition of export property;

(2) gross receipts from the lease or rental of export property that is used by the lessee of the property outside the U.S.;

(3) gross receipts for services that are related and subsidiary to any qualified sale, exchange, lease, rental, or other disposition of export property by the corporation;

(4) gain from the sale, exchange, or other disposition of qualified export assets (other than export property);

(5) dividends (or amounts includible in gross income under section 951) with respect to stock of a related foreign export corporation;

(6) interest on any obligation that is a qualified export asset;

(7) gross receipts for engineering or architectural services for construction projects located (or proposed for location) outside the U.S.; and

(8) gross receipts for the performance of managerial services in furtherance of the production of other qualified export receipts of a DISC.

(b). Qualified export assets.—Qualified export assets of a corporation are:

(1) export property;

(2) assets used primarily in connection with the sale, lease, rental, storage, handling, transportation, packaging, assembly, or servicing of export property, or the performance of engineering or architectural services as described in section 993(a)(1)(G) or managerial services in the furtherance of the production of qualified export receipts as described in section 993(a)(1)(A), (B), (C), and (G);

(3) accounts receivable and evidences of indebtedness that arise by reason of transactions described in section 993(a)(1)(A), (B), (C), (D), (G), or (H);

(4) money, bank deposits, and other similar temporary investments that are reasonably necessary to meet the working capital requirements of the corporation;

(5) obligations arising in connection with a producer's loan;

(6) stock or securities of a related foreign export corporation;

(7) certain obligations issued, guaranteed, or insured, in whole or in part, by the Export-Import Bank of the U.S. or the Foreign Credit Insurance Association in those cases where the obligations are acquired from the bank or association or from the seller or purchaser of the goods or services from which the obligations arose;

(8) certain obligations issued by a domestic corporation organized solely for the purpose of financing sales of export property pursuant to an agreement with the Export-Import Bank of the U.S. under which the corporation makes export loans guaranteed by the bank; and

(9) amounts (other than reasonable working capital) on deposit in the U.S. that are utilized during the period provided by regulations to acquire other qualified export assets.

(c). Export property.—Export property is property (except property excluded under section 993(c)(2) and property in short supply):

(1) manufactured, produced, grown, or extracted in the U.S. by a person other than a DISC;

(2) held primarily for sale, lease, or rental, in the ordinary course of trade or business, by, or to, a DISC, for direct use, consumption, or disposition outside the U.S.;

(3) whose fair market value is not more than 50% attributable to articles imported into the U.S.; and

(4) not sold or leased (i) by a DISC, or with a DISC as commission agent, to another DISC that is a member of the same controlled group (as defined in section 993(a)(3)) as the DISC or (ii) by any person to a Western Hemisphere trade corporation (as defined in section 921) that is a related person (a member of the same controlled group as defined in section 993(a)(3)) or a relationship that would result in a disallowance of losses under section 267 or section 707(b)) immediately before or after a transaction with respect to the seller, lessor, or commission agent.

(d). Producer's loans.—An obligation subject to the rules provided in section 993(d)(2) and (3) will be treated as arising out of a producer's loan if:

(1) the loan, when added to the unpaid balance of all other producer's loans made by the DISC, does not exceed the accumulated DISC income at the beginning of the month in which the loan was made;

(2) the obligation is evidenced by a note (or other evidence of indebtedness) with a stated maturity date not more than 5 years from the date of the loan;

(3) the loan is made to a person engaged in the U.S. in the manufacturing, production, growing, or extraction of export property; and

(4) it is designated as a producer's loan at the time of the loan.

(e). Related foreign export corporation.—A DISC may acquire and receive income in the form of dividends and interest from the following investments that are related to exports from the U.S.

Foreign international sales corporation (FISC).—A foreign corporation is a related foreign export corporation if:

(1) stock possessing more than 50% of the total combined voting power of all classes of stock entitled to vote is owned directly by the DISC;

(2) 95% or more of the foreign corporation's gross receipts for its taxable year ending with or within the taxable year of the DISC consists of qualified export receipts described in section 993(a)(1)(A) through (D) and interest on any obligation described in section 993(b)(3) and (4); and

(3) the adjusted basis of the qualified export assets held by the foreign corporation at the close of the taxable year equals or exceeds 95% of the sum of the adjusted basis of all assets held by it at the close of the taxable year.

Real property holding company.—A foreign corporation is a related foreign export corporation if:

(1) stock possessing more than 50% of the total combined voting power of all classes of stock entitled to vote is owned directly by the DISC, and

(2) its exclusive function is to hold title to real property for the exclusive use (under a lease or otherwise) of the DISC because of a requirement of applicable foreign law that the DISC cannot hold title.

Associated foreign corporation.—A foreign corporation is a related foreign export corporation if:

(1) less than 10% of the total combined voting power of all classes of the foreign corporation's stock entitled to vote is owned (within the meaning of section 1563(d) and (e)) by the DISC or by a controlled group of corporations (within the meaning of section 1563) of which the DISC is a member, and

(2) the ownership of stock and securities in the foreign corporation by the DISC is determined to be reasonably in furtherance of a transaction or transactions giving rise to qualified export receipts of the DISC.

(f). Gross receipts.—The term gross receipts means the total receipts from the sale, lease, or rental of property held primarily for sale, lease, or rental in the ordinary course of a trade or business and gross income from all other sources.

In the case of commissions on the sale, lease, or rental of property, the amount taken into account will be the gross receipts on the sale, lease, or rental of the property on which the commissions arose.

(g). United States.—U.S. includes the Commonwealth of Puerto Rico and the possessions of the U.S.

Sec. 994. Inter-Company Pricing Rules

In the case of a sale of export property to a DISC by a person described in section 482, the taxable income of the DISC and the other person may be based upon a transfer price which would allow the DISC to derive taxable income attributable to the sale (regardless of the sales price actually charged) in an amount which does not exceed the greatest of:

(1) 4% of the qualified export receipts on the sale of the property by the DISC plus 10% of the export promotion expenses of the DISC attributable to the receipts,

(2) 50% of the combined taxable income of the DISC and the person which is attributable to the qualified export receipts on the property derived as the result of a sale by the DISC plus 10% of the export promotion expenses of the DISC attributable to the receipts, or

(3) taxable income based upon the sale price actually charged (subject to the rules provided in section 482).

Note: Generally, inter-company pricing rules (1) and (2) above will not permit the related person to price at a loss. See Schedule P (Form 1120–DISC).

Export promotion expenses are those expenses incurred to advance the distribution or sale of export property for use, consumption, or distribution outside the U.S. but do not include income tax. They include freight expenses to the extent of 50% of the cost of shipping export property aboard airplanes owned and operated by U.S. persons or ships documented under the laws of the U.S. in those cases where law or regulations do not require that the property be shipped aboard such airplanes or ships.

General Instructions

A. Corporations required to file Form 1120–DISC.—Form 1120–DISC must be filed by a domestic corporation that has elected to be treated as a DISC and has satisfied the requirements under section 992 for treatment as a DISC for the taxable year.

A "former DISC" (as defined in section 992(a)(3)), in addition to filing any other return required, must file Form 1120–DISC, and clearly mark that it is filing as a former DISC. The former DISC need not complete those items pertaining to the computation of taxable income, but must complete Schedules J, K, L, and M (Form 1120–DISC).

B. Where to file.—

If the principal business, office, or agency is located in	Use the following Internal Revenue Service Center address
New Jersey, New York City and counties of Nassau, Rockland, Suffolk, and Westchester	Holtsville, NY 00501

New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Andover, MA	05501
Alabama, Florida, Georgia, Mississippi, South Carolina	Atlanta, GA	31101
Michigan, Ohio	Cincinnati, OH	45999
Arkansas, Kansas, Louisiana, New Mexico, Oklahoma, Texas	Austin, TX	73301
Alaska, Arizona, Colorado, Idaho, Minnesota, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT	84201
Illinois, Iowa, Missouri, Wisconsin	Kansas City, MO	64999
California, Hawaii	Fresno, CA	93888
Indiana, Kentucky, North Carolina, Tennessee, Virginia, West Virginia	Memphis, TN	37501
Delaware, District of Columbia, Maryland, Pennsylvania	Philadelphia, PA	19255

The separate income tax returns of a group of Corporations located in several Service Center regions may be filed with the Service Center for the area in which the principal office of the managing corporation that keeps all the books and records is located.

C. When to file.—Form 1120–DISC must be filed on or before the 15th day of the 9th month following the close of the taxable year.

No extension of time to file will be granted.

D. Period to be covered by the 1979 return.—The 1979 return is to be filed for calendar year 1979 and fiscal years beginning in 1979 and ending in 1980. If the return is for a fiscal year, fill in the taxable year space on the form.

Final return.—If the corporation ceases to exist, write "FINAL RETURN" at the top of the form.

E. Change in accounting period.—To change an accounting period, see section 1.442–1 of the regulations and Form 1128, Application for Change in Accounting Period.

F. Accounting methods.—A DISC may, generally, choose any method of accounting permissible under section 446(c) and the regulations thereunder. However, if a DISC is a member of a controlled group (as defined in section 993(a)(3)), the DISC may not choose a method of accounting that, when applied to transactions between the DISC and other members of the controlled group, will result in a material distortion of the income of the DISC or any other member of the controlled group. A material distortion would occur, for example, if a DISC chooses to use the cash method of accounting where the DISC acts as a commission agent in a substantial volume of sales of property by a related corporation that uses the accrual method of accounting and customarily pays commissions to the DISC more than 2 months after the sales.

Unless the law specifically permits, you may not change the method of accounting used to report income in prior years (for income as a whole or for any material item) without first obtaining consent on Form 3115, Application for Change in Accounting Method.

Rounding off to whole-dollar amounts.—Money items may be shown as whole-dollar amounts by dropping any amount less than 50 cents and increasing any amount from 50 cents through 99 cents to the next higher dollar.

G. Stock ownership in foreign corporations.—If you owned 5% or more in value of the outstanding stock of a foreign personal holding company, attach the statement required by section 551(c).

If you control a foreign corporation or were a 10% or more shareholder of a controlled foreign corporation, you may be required to file Forms 2952 and 3646.

H. Financial statements.—The balance sheets must agree with your books and records. Any differences must be reconciled.

I. Attachments.—If more space is needed on forms or schedules, attach separate sheets. Attach schedules in alphabetical order and forms in numerical order to the back of Form 1120–DISC. Be sure to put the taxpayer's name and employer identification number on these separate sheets.

J. Amended return.—Correct any error in a previously filed return by filing an amended Form 1120–DISC.

K. Signature.—The return must be signed and dated by the president, vice president, treasurer, assistant treasurer, chief accounting officer, or by any other corporate officer (such as tax officer) authorized to sign.

A receiver, trustee, or assignee must sign any return that he is required to file on behalf of a corporation.

If your corporate officer filled in Form 1120–DISC, the space under the signature of officer should remain blank. If someone prepares Form 1120–DISC and does not charge the corporation, that person should not sign the return. Certain others who prepare Form 1120–DISC should not sign. For example, a regular full-time employee of the corporation such as clerk, secretary, etc., does not have to sign. (This list is not all inclusive.)

Generally, anyone who is paid to prepare Form 1120–DISC must sign the return and fill in the other blanks in the Paid Preparer's Information area of the return.

When more than one person prepares Form 1120–DISC, the preparer with primary responsibility for the overall accuracy of the return must sign as the preparer.

If the preparer is self-employed (i.e., is not employed by any person or business entity to prepare the return), he or she should check the "self-employed" box in the preparer's section of Form 1120–DISC.

If you have questions about whether a preparer is required to sign Form 1120–DISC, please contact an IRS office.

The person required to sign the return MUST complete the required preparer information and:

- Sign it, by hand, in the space provided for the preparer's signature (signature stamps or labels are not acceptable);
- Give a copy of Form 1120–DISC to the taxpayer in addition to the copy filed with IRS.

Tax return preparers should be familiar with their responsibilities. **Publication 1045,** Information for Preparers of Federal Income Tax Returns lists some of the preparer's responsibilities and penalties for which he or she may be liable. The publication also contains the regulation citations which govern their work. This publication is available at IRS offices.

L. Total assets.—If there are no assets at the end of the taxable year, enter the total assets at the beginning of the taxable year.

M. Penalty for failure to file returns and provide information.—A penalty is imposed by section 6686 (in addition to the penalty imposed by section 7203) on any person required to supply information or file a return who fails to supply information or file a return at the time prescribed or who files a return that does not show the information required.

Unless it is shown that the failure is due to reasonable cause, the penalty is (1) $100 for each failure to supply information (the total amount imposed for all failures during any calendar year will not exceed $25,000) or (2) $1,000 for each failure to file a return.

N. Taxation of a DISC.—A DISC is not subject to any tax imposed by sections 1 through 1564 except for the tax imposed by sections 1491 through 1494 on certain transfers to avoid tax.

A DISC is not subject to the corporate income tax, the minimum tax on tax preferences, or the accumulated earnings tax.

A DISC is subject to the provisions of sections 1441 through 1461 relating to withholding of tax on nonresident aliens and foreign corporations.

O. Investment credit, work incentive (WIN) credit, and the jobs credit.—The investment credit, the work incentive (WIN) credit and the jobs credit do not apply to a DISC and they do not pass through to any shareholder in a DISC.

P. Nonresident alien individuals and foreign corporations, trusts, and estates.—Treat all gains on the disposition of stock in a DISC or former DISC and all distributions out of accumulated DISC income, including deemed distributions, as effectively connected with the conduct of a trade or business conducted through a permanent establishment within the U.S.

Q. Stock ownership.—For rules of stock attribution, see section 267(c). If the owner of the voting stock of the DISC was an alien individual or a foreign entity (corporation, partnership, trust, or estate), so indicate by placing an X in the "Yes" box in the "Foreign Owner" column and enter the name of the owner's country in parentheses in the address column. "Owner's country" for

individuals is their country of residence; for other foreign entities, it is the country in which organized or otherwise created, or in which administered.

R. Foreign financial accounts and foreign trusts.—

Question R: Check the Yes box if either (1) or (2) below applies to you.

(1) At any time during the year you had an interest in or signature or other authority over a bank account, securities account, or other financial account in a foreign country. *Exception:* Check No if either of the following apply to you:

- The combined value of the accounts was $1,000 or less during the whole year.
- The accounts were with a U.S. military banking facility operated by a U.S. financial institution.

(2) You own more than 50% of the stock in any corporation that owns one or more foreign bank accounts.

Get Form 90–22.1 to see if you are considered to have an interest in or signature or other authority over a bank account, securities accounts, or other financial account in a foreign country.

If you checked Yes for Question R, file Form 90–22.1 by June 30, 1980, with the Department of the Treasury at the address shown on the form. Form 90–22.1 is not a tax return, so do not file it with the IRS.

You can get Form 90–22.1 from many IRS offices.

Question S: Check the Yes box if you were a grantor of or a transferor to a foreign trust that existed during the tax year.

S. Travel and entertainment (section 274(d).—(See Form 1120–DISC item I, page 5). The amount required to be entered is the total amount expended during the year for entertainment, entertainment facilities, gifts, travel, and conventions for which substantiation would be required under section 274(d).

Expenditures paid or incurred in tax years beginning in 1979 that are included in the cost of inventory, merchandise purchased for resale, or capitalized in asset accounts, etc., should be reported in the total as if they were fully deducted on the return even though all or a portion of such expenditures are included in ending inventory, asset accounts, etc.

Do not include amounts treated as compensation and reported on Forms W–2.

See Regulation section 1.274–5 for definitions and rules governing the types of expenses for which substantiation is required and therefore reportable in item I.

***Note:** Generally, for taxable years ending after December 31, 1978, no deduction is allowed for any expense paid or incurred with respect to a facility which is used in connection with an activity which is of a type generally considered to constitute entertainment, amusement, or recreation. See section 274(a).*

Specific Instructions

(Numbered to correspond with the line numbers on page 1 of the return.)

5. Cost of goods sold.—Enter the amount shown on line 7, Schedule A.

Cost of operations (where inventories are not an income-determining factor).—If the amount entered on line 5 includes an amount applicable to cost of operations, attach a schedule showing (1) salaries and wages and (2) other costs in detail.

Computation of Taxable Income

11(a). Net operating loss deduction.—The "net operating loss deduction" is the sum of the net operating loss carryovers and carrybacks to the taxable year. (Section 172(a).)

A net operating loss may be carried back to each of the 3 years preceding the year of each loss and carried over to each of the 7 years following the year of such loss; or, an election may be made whereby a net operating loss may be carried over to each of the 7 years following the year of such loss. After applying the net operating loss to the initial year, the portion of the loss that may be carried to each of the remaining taxable years is the excess, if any, of the loss over the sum of the taxable income for each of the prior taxable years to which the loss may be carried. (Section 172(b).)

The "net operating loss" is the excess of allowable deductions over gross income, computed with the following modifications under section 172(d):

(1) No net operating loss deduction is allowed.

(2) The dividends-received deduction in line 1 of Schedule I is computed without regard to the 85% limitation provided in section 246(b). See section 1.172–2 of the regulations.

A deficit in earnings and profits is chargeable in the following order:

(1) first, to other earnings and profits, to the extent thereof;

(2) second, to accumulated DISC income, to the extent thereof; and

(3) finally, to previously taxed income,

except that a deficit in earnings and profits will not be applied against accumulated DISC income which has been determined is to be deemed distributed to the shareholders (pursuant to section 995(b)(2)(A)) as a result of a revocation of election or other disqualification.

In determining the taxable income that must be subtracted from a net operating loss to determine the portion of the loss that will still be available to carry to a subsequent year, the net operating loss deduction is determined without regard to the net operating loss for the loss year or any taxable year thereafter, and, under certain circumstances, without regard to any portion of a net operating loss attributable to a foreign expropriation loss.

12. Taxable income.—If either the gross receipts method or combined taxable income method is chosen for computing the taxable income of the DISC attributable to a transaction or group of transactions consisting of products or product lines, attach a Schedule P (Form 1120–DISC) showing, in detail, the computation of the DISC's taxable income attributable to each such transaction or group of transactions.

Schedule A.—Cost of goods sold

If inter-company pricing rules are used, reflect in Schedule A **actual** purchases from a related supplier at the transfer price determined under the inter-company pricing rules of section 994. See Schedule P (Form 1120–DISC).

Where the DISC acts as a commission agent on a sale for any person, do not enter any amount in Schedule A for such sale. See Schedule P (Form 1120–DISC).

Valuation Methods.—Inventories can be valued at: (a) cost, (b) cost or market value (whichever is lower), or (c) any other method approved by the Commissioner of Internal Revenue, where those methods conform with the provisions of the applicable regulations cited below.

Taxpayers using erroneous valuation methods should request permission to change to a method permitted for Federal tax purposes. For further information regarding the change, see Regulation section 1.446–1(e)(3).

Check the method(s) used for valuing inventories in line 8(a). Under "lower of cost or market," market generally applies to normal market conditions where there is a current bid price prevailing at the date the inventory is valued. When no regular open market exists or when quotations are nominal because of inactive market conditions, use fair market prices from the most reliable sales or purchase transactions that occurred near the date the inventory is valued. For additional requirements, see Regulation section 1.471–4.

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are "subnormal" (that is, because of damage, imperfections, shop wear, etc.) within the meaning of Regulation section 1.471–2(c). Such goods may be valued at a current bona fide selling price less direct cost of disposition (but not less than scrap value) where the taxpayer can establish such a price. See Regulation section 1.471–2(c) for additional requirements.

In line 8(b), indicate whether you used a method of inventory valuation other than those described in line 8(a) and attach a statement describing the method used.

If this is the first year the "Last-in, First-out" (LIFO) inventory method provided in section 472 was adopted and used, attach Form 970 or a statement with the information required by Form 970 to Form 1120–DISC and check the LIFO box in line 8(c). Enter the amount or percent (estimates may be used) of total closing inventories covered under section 472 in line 8(d).

Schedule B.—Gross Income

(Numbered to correspond with the line numbers in Schedule B.)

Enter gross income in lines 1 through 3 categorized as either (1) qualified export receipts from the sale of export property, (2) other qualified export receipts, or (3) nonqualified gross receipts. If an income item consists of two or more categories, report each on the applicable line. For example, if interest income consists of qualified interest from a foreign international sales corporation and nonqualified interest from a domestic obligation, enter the qualified interest on an attached schedule for line 2(g) and the nonqualified interest on an attached schedule for line 3(f).

Special rule when the DISC acts as a commission agent.—For commissions on the sale, lease, or rental of property, or the furnishing of services, list in column B the gross receipts on the sale, lease, or rental of property, or the furnishing of services on which the commissions arose and in column C the commissions earned. Receipts from non-commission sales, leases, rentals, or the furnishing of services and all other receipts should be reported on the appropriate lines in column D. Column E is the sum of commissions reported in column C and receipts from non-commission sales, leases, or rentals and all other receipts reported in column D.

See instructions for lines 2(h) and 2(i) for details regarding the reporting of gains from sale of qualified export assets.

If you use the installment method of reporting, attach a schedule showing for the current and 3 preceding years: (a) gross sales, (b) cost of goods sold, (c) gross profit, (d) percentage of gross profit to gross sales, (e) amount collected, and (f) gross profit on the amount collected.

1. Qualified export receipts from the sale of export property.—These are receipts from the sale of property, such as inventory, produced in the U.S. for direct use, consumption, or disposition outside the U.S.

For a sale to meet the export requirement, it must meet (1) a destination test and (2) a requirement that the sale not be for ultimate use in the U.S.

The destination test will be considered satisfied if the property is delivered (regardless of the F.O.B. point or the place at which title passes or risk of loss shifts from the seller or lessor):

(a) Within the U.S. to a carrier or freight forwarder for ultimate delivery outside the U.S. to a purchaser or lessee (or to a subsequent purchaser or sublessee);

(b) Within the U.S. to a purchaser or lessee, if the property is ultimately delivered outside the U.S. (including delivery to a carrier or freight forwarder for delivery outside the U.S.) by the purchaser or lessee (or a subsequent purchaser or sublessee) within one year after the sale or lease;

(c) Within or outside the U.S. to a purchaser or lessee that, at the time of the sale or lease, is a DISC and is not a member of the same controlled group (as defined in section 993(a)(3)) as the seller or lessor;

(d) From the U.S. to the purchaser or lessee (or a subsequent purchaser or sublessee) at a point outside the U.S. by means of the seller's or lessor's own ship, aircraft, or other delivery vehicle;

(e) Outside the U.S. to a purchaser or lessee from a warehouse, a storage facility, or assembly site located outside the U.S., if the property was previously shipped by the seller or lessor from the U.S.; or

(f) Outside the U.S. to a purchaser or lessee if the property was previously shipped by the seller or lessor from the U.S. and if the property is located outside the U.S. pursuant to a prior lease by the seller or lessor, and either (a) the prior lease terminated at the expiration of its term (or by the action of the prior lessee acting alone), (b) the sale occurred or the term of the subsequent lease began after the time at which the term of the prior lease would have expired, or (3) the lessee under the subsequent lease is not a related person (a member of the same controlled group as defined in section 993(a)(3)) or a relationship that would result in a disallowance of losses under section 267 or section 707(b)) immediately before or after the lease with respect to the lessor and the prior lease was terminated by the action of the lessor (acting alone or together with the lessee).

The second part of the export requirement for sales is that the sale must not be for ultimate use in the U.S. This test is applied at the time of the sale. If the property is to be used predominantly outside the U.S., the sale is not for ultimate use in the U.S.

Property sold to an unrelated person is considered sold for ultimate use in the U.S. if it is sold pursuant to an agreement or understanding that it will be used in the U.S. or if a reasonable person would have believed that it will be used in the U.S.

For example, if property is sold to a foreign wholesaler and it is known in trade circles that the wholesaler, to a substantial extent, supplies the U.S. retail market, the sale would not be a qualified export sale.

Special rules apply for certain exported components incorporated into products imported into the U.S.

In general, related purchasers are purchasing corporations that are members of the same controlled group (as defined in section 993(a)(3)) as the DISC. Unrelated purchasers are all other purchasers.

1(a).—Enter the DISC's qualified export receipts (other than those entered on line 1(b)) from sales of export property to foreign unrelated purchasers for delivery outside the U.S.

1(b).—Enter the DISC's qualified export receipts from sales of export property for delivery outside the U.S. to (i) a related foreign entity for resale (directly or indirectly) to a foreign unrelated purchaser, or (ii) an unrelated purchaser where a related foreign entity acts as commission agent. A related foreign entity is a foreign corporation that is a member of the same controlled group (section 993(a)(3)) as the DISC.

2(a). Leasing of export property.—Enter the gross amount received from the leasing (including subleasing) of export property to unrelated persons for use outside the U.S.

Whether the leased property satisfies the usage test is to be determined on a year-by-year basis.

The receipts from a lease of export property may qualify in some years and not in other years depending upon the place where the lessee uses the property in the years involved.

Deduct expenses such as repairs, interest, taxes, and depreciation on the proper lines for such deductions.

2(b). Services related and subsidiary to a qualified export sale or lease.—A service is related to a sale or lease if it is of a kind customarily and usually furnished with that type of transaction in a trade or business in which the transaction arose and if the agreement to furnish the services is connected with the sale or lease. A service is subsidiary if it is of less importance and value as compared to the sale or lease.

2(c). Engineering and architectural services.—Receipts from engineering or architectural services on foreign construction projects which are either located abroad or proposed for location abroad are qualified receipts. They include feasibility studies, design and engineering, and general supervision of construction but do not include services connected with exploration for minerals.

2(d). Export management services.—Include receipts for export management services provided to unrelated DISCs.

2(f). Interest on producer's loans.—A producer's loan must be evidenced by a note or other evidence of indebtedness, be designated as a producer's loan, have a stated maturity not to exceed 5 years, and be attributable to the borrower's assets used in exporting and research and development.

2(g). Other interest.—Enter interest on any qualified export asset other than interest on producer's loans.

Include, for example, interest on accounts receivable arising out of sales in which the DISC acted as a principal or agent and interest on certain obligations issued, guaranteed, or insured by the Export-Import Bank or the Foreign Credit Insurance Association.

2(h). Capital gain net income.—Every sale or exchange of a capital asset must be reported in detail on a separate Schedule D (Form 1120) even though no gain or loss is indicated.

In addition to completing Schedule D (Form 1120), attach a separate schedule computing the gain from the sale of qualified export assets.

2(i). Ordinary gain or (loss).—Enter the total ordinary gain or loss from line 17, Part II, Form 4797.

In addition to completing Form 4797, attach a separate schedule computing the gain from the sale of qualified export assets.

3(b). Exports subsidized by the U.S. Government.—Enter receipts from the sale of products subsidized under a program of the U.S. Government, or any instrumentality thereof, that have been designated as excluded receipts.

3(c). Certain direct or indirect sales or leases for use by the U.S. Government.—Enter receipts from direct or indirect sales or leases of property or services for use by the U.S. Government, or any instrumentality if the use of U.S. products or services is required by statute or regulations.

3(d). Sales to another DISC in the same controlled group.—Enter receipts from a DISC that is a member of the same controlled group of corporations. See section 993(a)(3) for the definition of controlled group.

3(f). Other.—Include in an attached schedule any nonqualified gross receipts not reported on lines 3(a) through 3(e). Do not offset an income item against a similar expense item.

Schedule C.—Dividends

(Numbered to correspond with the line numbers in Schedule C.)

1. Enter dividends received from domestic corporations subject to income tax and the 85% deduction under section 243(a)(1).

Include on this line taxable distributions received from a DISC or former DISC that are eligible for the 85% dividends-received deduction.

For dividends received from a regulated investment company, see section 854 for the amount subject to the 85% deduction.

So-called dividends or earnings received from mutual savings banks, etc., are really interest and should not be treated as dividends.

2. Enter dividends received on the preferred stock of a public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

3. Enter dividends received from foreign corporations that qualify for the 85% deduction in section 245(a).

4. Enter dividends received from wholly-owned foreign subsidiaries that are eligible for the 100% deduction provided in section 245(b).

5. Enter foreign dividends that are not reportable on lines 3 and 4. Exclude distributions of amounts constructively taxed in the current year or in prior years under subpart F.

6. Include income constructively received from controlled foreign corporations under subpart F. This amount should equal the total of amounts on Schedule A, line 5 of Form(s) 3646.

7. Enter taxable distributions from a DISC or former DISC that are designated as not being eligible for the 85% dividends-received deduction. (See sections 246(d), 995(b), and 996(a)(3).)

8. Include dividends (other than capital gain dividends) received from regulated investment companies that are not subject to the 85% deduction; dividends from tax-exempt organizations; dividends (other than capital gain dividends) received from a real estate investment trust which, for the taxable year of the trust in which the dividends are paid, qualifies under sections 856 through 860; dividends not eligible for a dividends-received deduction because of the holding period of the stock or an obligation to make corresponding payments with respect to similar stock; and any other taxable dividend income not properly reported above.

10. Enter dividends (and income constructively received from controlled foreign corporations under subpart F) from a qualified foreign investment of a DISC in a related foreign export corporation which constitute qualified dividends. Generally, the investment will be in stock or securities of a foreign selling subsidiary of the DISC which qualifies as a foreign international sales corporation (FISC).

Schedule E.—Deductions

(Numbered to correspond with the line numbers in Schedule E.)

Enter export promotion expenses in line 1. Export promotion expenses are a DISC's ordinary and necessary expenses paid or incurred to obtain qualified export receipts (but do not include income taxes). Any expense (or any part of an expense) not incurred to obtain qualified export receipts should be entered in line 2.

1(c). Depreciation.—Attach Form 4562 if you claim a deduction for depreciation. Enter on this line the depreciation not claimed in Schedule A and elsewhere on the return.

1(h). Freight.—Enter one-half of the freight expenses (not including insurance) for shipping export property aboard U.S. flag vessels and U.S. owned and operated aircraft (unless required by law).

1(i). Compensation of officers.—Attach a schedule showing the name, social security number, amount of compensation, and expense account allowance for your 6 highest paid officers.

To determine the highest paid officers, add all allowances, including expense account allowances, to each officer's compensation. Expense account allowance means (1) amounts, other than compensation, received as advances or reimbursements and (2) amounts paid by or for the corporation for expenses incurred by or on behalf of an officer. Do not show expense account allowance for any officer whose combined compensation and expense account allowance is less than $30,000.

An officer is a person, such as regular officer, chairman of the board, etc., who is elected or appointed to office or who is designated as an officer in the corporation's charter or bylaws.

1(j). Repairs.—Enter the cost of incidental repairs, such as labor and supplies, that do not add to the value or appreciably prolong the life of the property. Include on this line the total amount of repairs figured under the Class Life Asset Depreciation Range (CLADR) System.

1(k). Amortization.—If a deduction for amortization is claimed, attach a schedule showing: (1) a description of the expenditures being amortized; (2) date acquired, completed, or expended; (3) amount being amortized; (4) amortization deducted in prior years; (5) amortization period (number of months); (6) amortization for this year; and (7) the total amount of amortization less the amount claimed in Schedule A and elsewhere on the return.

1(l). Pension, profit-sharing, etc. plans.—The number of plans to be entered refers to all plans for which all assets have not been distributed. Also include any plans in which assets were distributed in the current year. The number of plans must be indicated whether or not a deduction is claimed. Except for simplified employee pension plans complete Form 5500 for each plan and file each as a separate return. Complete Form 5500–C in lieu of Form 5500 if there were fewer than 100 participants at the beginning of the plan year. See instructions for above forms for computation of the amount of allowable deduction. File these forms on or before the last day of the 7th month following the close of the plan year.

Caution: *ERISA imposes penalties for failure to furnish complete information and failure to file statements, returns and reports.*

1(m). Employee benefit programs.—Enter the amount of your contributions to employee benefit programs (e.g. insurance, health and welfare programs) that are not an incidental part of a pension, profit-sharing, etc., plan included on line 1(l). Also include contributions to a qualified group legal services plan. Section 120 imposes certain rules on an employer which will permit employees (including spouses and dependents) to exclude from income employer contributions to a qualified group legal services plan.

2(a). Bad debts.—Bad debts may be treated in either of two ways—(i) as a deduction for debts that become worthless in whole or in part, or (ii) as a deduction for a reasonable addition to a reserve for bad debts. (Section 166.)

Application to change the method of computing bad debts must be made on Form 3115.

2(b). Taxes.—Enter taxes paid or accrued during the taxable year.

See section 164(d) for apportionment of tax on real property between seller and purchaser.

2(c). Interest.—Do not include interest on indebtedness incurred or continued to purchase or carry obligations on which the interest is wholly exempt from income tax. (Section 265.)

See section 267 for the limitation on deductions for unpaid expenses and in-

terest in transactions between related taxpayers.

See section 461(g) for limitation on deduction for prepaid interest by a cash basis taxpayer.

2(d). Contributions.—Enter contributions or gifts actually paid within the taxable year to or for the use of charitable and governmental organizations described in section 170(c) and any unused contributions carried over from prior years.

The total amount claimed may not exceed 5% of taxable income (line 12 of page 1) computed without regard to (1) any deduction for contributions, (2) the dividends-received deduction on line 11(b) of page 1, (3) deductions allowed under sections 249 and 250, (4) any net operating loss carryback to the taxable year under section 172, and (5) any capital loss carryback to the taxable year under section 1212(a)(1).

Charitable contributions in excess of the 5% limitation may not be deducted for the taxable year but may be carried over to the next 5 taxable years.

A contribution carryover is not allowed to the extent that it increases a net operating loss carryover. See section 170(d)(2)(B).

Corporations on the accrual basis may elect to deduct contributions paid on or before the 15th day of the 3d month following the close of the taxable year if the contributions are authorized by the board of directors during the taxable year. A declaration, signed by an officer, stating that the resolution authorizing the contributions was adopted by the board of directors during the taxable year, and a copy of the resolution, must both be attached to the return.

Attach a schedule showing the name of each organization and the amount paid. If a contribution is made in property other than money, describe the kind of property contributed and the method used in determining its fair market value. If a contribution carryover is included, show the amount and how it was determined.

Special rule for contributions of certain property.—If a charitable contribution of property is made, the contribution must be reduced by the sum of

(1) the ordinary income and

(2) for certain contributions, 60.87% of the long-term capital gain,

that would have resulted if the property were sold at its fair market value. The reduction for 60.87% of the long-term capital gain applies to (1) contributions of tangible personal property for use by an exempt organization for a purpose or function unrelated to the basis for its exemption, and (2) contributions of any property to or for the use of certain private foundations. (Section 170(e).)

For special rules regarding the contribution of inventory, and other ordinary income property to certain organizations, see section 170(e)(3).

Bargain sale to a charitable organization.—If a charitable contribution deduction for property sold to a charitable organization is claimed, the adjusted basis for determining gain from the sale is an amount which is in the same ratio to the adjusted basis as the amount realized is to the fair market value of the property.

2(e). Freight.—Enter the freight expense not deducted on line 1(h) as an export promotion expense.

2(f). Other.—No deduction is allowable for any amount allocable to a class of exempt income. Items directly attributable to wholly exempt income must be allocated to such income, and items directly attributable to any class of taxable income must be allocated to such taxable income.

If an item is indirectly attributable both to taxable income and exempt income, a reasonable proportion of the item, determined in the light of all the facts and circumstances in each case, must be allocated to each.

Attach a statement showing (1) the amount of each class of exempt income and (2) the amount of expense items allocated to each class. Show the amount allocated by apportionment separately.

Schedule I.—Dividends-received deduction

1. In general, no dividends-received deduction will be allowed on any share of stock (a) that is disposed of before the corporation has held it 15 days or less or (b) to the extent the corporation is under an obligation to make corresponding payments with respect to substantially identical stock or securities.

No deduction is allowed under section 243 for a dividend from a DISC or former DISC (as defined in section 992(a)) to the extent it is paid out of accumulated DISC income or previously taxed income or is a deemed distribution pursuant to section 995(b)(1).

2. Limitation on dividends-received deduction.—Line 2 may not exceed 85% of line 10, page 1.

For this purpose, line 10 is to be computed without regard to any capital loss carryback to the taxable year under section 1212(a)(1).

In a year in which a net operating loss occurs, sections 172(d) and 246(b) provide that this 85% limitation does not apply even if the loss is created by the dividends-received deduction.

Schedule J.—Deemed and Actual Distributions to Shareholders for the Taxable Year

Part I.—Deemed distributions under section 995(b)(1) (Numbered to correspond with the line numbers in Part I of Schedule J.)

2. Attach a computation showing the gain recognized by the DISC during the taxable year on the sale or exchange of property, other than property which in the hands of the DISC is a qualified export asset, previously transferred to it in a transaction in which gain was not recognized in whole or in part, but only to the extent that the transferor's gain on the previous transfer was not recognized.

3. Attach a computation showing the gain (other than the gain entered on line 2) recognized by the DISC during the taxable year on the sale or exchange of property (other than property which in the hands of the DISC is stock in trade or other property described in section 1221(1)) previously transferred to it in a transaction in which gain was not recognized in whole or in part, but only to the extent that the transferor's gain on the previous transfer was not recognized and would have been treated as ordinary income if the property had been sold or exchanged rather than transferred to the DISC.

4. For purposes of computing the portion of taxable income attributable to military property, use the gross income for the year attributable to military property and the deductions which are properly apportioned or allocated to such income. See section 38 of the International Security Assistance and Arms Export Control Act of 1976 (22 USC 2778) and regulations thereunder (22 CFR 121.01) for definition of "military property."

11. Under section 995(b)(1)(F)(ii), a DISC is deemed to distribute the entire amount of its income attributable to participation in or cooperation with an international boycott. See Form 5713 for computation of this deemed distribution and reporting requirements of any DISC with operations in or related to a "boycotting" country.

12. Under section 995(b)(1)(F)(iii), a DISC is deemed to distribute the amount of any illegal bribe, kickback or other payment paid by or on behalf of the DISC, directly or indirectly, to an official, employee or agent of any government.

14. Attach a computation showing the earnings and profits for the taxable year.

For purposes of computing the earnings and profits for taxable years beginning after June 30, 1972, the allowance for depreciation (and amortization, if any) is the amount which would be allowable for such year if the straight-line method of depreciation had been used for each taxable year beginning after June 30, 1972. See section 312(k)(2) for exception.

16. Attach a computation showing the amount of (1) foreign investment attributable to producer's loans (as defined in section 995(d)) of the DISC for the taxable year; (2) all accumulated earnings and profits including

earnings and profits for the taxable year less the amount on line 15, Part I; and (3) accumulated DISC income. Enter the smaller of these 3 amounts (but not less than zero) on line 16.

Foreign investment attributable to producer's loans will be the smallest of these 3:

(1) the net increase in foreign assets by members of the controlled group (as defined in section 993(a)(3)) that includes the DISC,

(2) the actual foreign investment by domestic members of the group, or

(3) the amount of the DISC's outstanding producer's loans to members of the controlled group.

For the definitions of "net increase in foreign assets" and "actual foreign investment," see sections 995(d)(2) and 995(d)(3).

Part II.—Computation of Taxable Income Attributable to Base Period Export Gross Receipts

(Numbered to correspond with the line numbers in Part II of Schedule J.)

4. Include the annualized taxable income but no taxable losses incurred by any DISC which is a member of your controlled group (as defined in section 993(a)(3)) for the latest taxable year ending with or within your taxable year.

5. If this amount is $100,000 or less, omit lines 6 through 21 and enter zero on line 22 and on line 8, Part I.

6. Column C.—Generally, if export property does not qualify in the current year under 993(c)(2) as giving rise to export gross receipts, then the gross receipts from such property should be excluded in computing the export gross receipts for the base period.

However, if, by virtue of section 603(b)(2) of the Tax Reduction Act of 1975, export property qualifies in the current year as giving rise to export gross receipts, then the DISC must increase its export gross receipts for the base period. See section 1101(g)(5) of the Tax Reform Act of 1976 for computation to be used.

Note: *Enter gross receipts, not just commissions, in the case of transactions made on a commission basis.*

11b. Additions must be made to base period export gross receipts in certain cases where there has been a separation in ownership of the stock in the DISC from ownership in the underlying trade or business which produced the export gross receipts during the base period, and in cases where any 5% or more shareholder owned 5% or more of the stock of another DISC in any base period year. (See sections 995(e)(9) and 995(e)(10).)

15. Include on this line the annualized export gross receipts of all DISCs which are members of your controlled group (as defined in section 993(a)(3)) for their latest taxable year ending with or within your taxable year.

Part III.—Deemed distribution under section 995(b)(2)

A shareholder of a corporation that revoked its election to be treated as a DISC or failed to qualify as a DISC for a taxable year will be deemed to have received a distribution taxable as a dividend equal to his pro rata share of the DISC income of the corporation accumulated during the immediately preceding consecutive taxable years for which the corporation was a DISC. The distributions will be deemed to be received in equal installments on the last day of each of the 10 taxable years of the corporation following the year of the termination or disqualification (but in no case over more than twice the number of immediately preceding consecutive taxable years during which the corporation was a DISC).

Schedule K.—Shareholder's Statement of DISC Distribution

Attach a separate Copy A, Schedule K (Form 1120–DISC) to Form 1120–DISC for each shareholder who had an actual or deemed distribution during the DISC's taxable year.

Schedule N.—Export Gross Receipts of the DISC and Related U.S. Persons

Complete and attach Schedule N (Form 1120–DISC) to Form 1120–DISC.

Schedule P.—Computation of Inter-company Transfer Price or Commission

Attach a separate Schedule P (Form 1120–DISC) for each transaction or group of transactions to which the inter-company pricing rules of section 994 (a)(1) and (2) are applied.

Codes for Principal Business Activity

These industry titles and definitions are based, in general, on the Enterprise Standard Industrial Classification system developed by the Office of Management and Budget, Executive Office of the President, to classify enterprises by type of activity in which they are engaged. The system follows closely the Standard Industrial Classification used to classify establishments. However, certain activities such as manufacturing, do not apply to a DISC.

Using the list below, enter on page 1, under B, the code number for the specific industry group from which the largest percentage of "total receipts" is derived. "Total receipts" means all income (line 4, page 1). On page 5, question J, state the principal business activity and principal product or service that account for the largest percentage of total receipts. For example, if the principal business activity is "Wholesale trade: Machinery, equipment, and supplies," the principal product or service may be "Engines and turbines."

TRANSPORTATION, COMMUNICATION, ELECTRIC, GAS, AND SANITARY SERVICES

Code

Transportation:
4400 Water transportation
4700 Other transportation services

Electric, gas, and sanitary services:
4910 Electric services
4920 Gas production and distribution
4930 Combination utility services

WHOLESALE TRADE

Durable:
5008 Machinery, equipment, and supplies
5010 Motor vehicles and automotive equipment
5020 Furniture and home furnishings
5030 Lumber and construction materials
5040 Sporting, recreational, photographic, and hobby goods, toys, and supplies
5050 Metals and minerals, except petroleum and scrap
5060 Electrical goods
5070 Hardware, plumbing and heating equipment
5098 Other durable goods

Code

Nondurable:
5110 Paper and paper products
5129 Drugs, drug proprietaries, and druggists' sundries
5130 Apparel, piece goods, and notions
5140 Groceries and related products
5150 Farm-product raw materials
5160 Chemicals and allied products
5170 Petroleum and petroleum products
5180 Alcoholic beverages
5190 Miscellaneous nondurable goods

RETAIL TRADE

Building materials, hardware, garden supply, and mobile home dealers:
5220 Building materials dealers
5251 Hardware stores
5265 Garden supplies and mobile home dealers
5300 General merchandise stores
5410 Grocery stores
5490 Other food stores

Automotive dealers and service stations:
5515 Motor vehicle dealers
5541 Gasoline service stations
5598 Other automotive dealers

Code

5600 Apparel and accessory stores
5700 Furniture and home furnishings stores
5800 Eating and drinking places

Miscellaneous retail stores:
5912 Drug stores and proprietary stores
5921 Liquor stores
5995 Other miscellaneous retail stores

FINANCE, INSURANCE, AND REAL ESTATE

Credit agencies other than banks:
6199 Other credit agencies

SERVICES

Business services:
7389 Export management services

Auto repair and services; miscellaneous repair services:
7500 Lease or rental of motor vehicles

Amusement and recreation services:
7812 Motion picture production, distribution, and services

Other services:
8911 Architectural and engineering services
8930 Accounting, auditing, and bookkeeping
8980 Miscellaneous services

SCHEDULE N
(Form 1120–DISC)
Department of the Treasury
Internal Revenue Service

Export Gross Receipts of the DISC and Related U.S. Persons

▶ See separate instructions.
▶ Attach this schedule to Form 1120–DISC.

1979

Name as shown on Form 1120–DISC

Employer identification number

Export gross receipts of the DISC by product code (See specific instruction A)

Product code number	Percent of export gross receipts

Part I

Section A.—Export Gross Receipts in the Current Year by Country (See specific instruction B)

1 Country of ultimate destination (Use one line for each country)	2 Export gross receipts of the DISC	Export gross receipts of related U.S. persons	
		3 Related DISCs	4 All other related U.S. persons
United States (including Puerto Rico and U.S. possessions)			

Part II

Section A.—Related U.S. Persons, Except DISCs, in Your Controlled Group (Attach additional copies of this schedule if necessary)

Name	Address	Identifying number

Section B.—DISCs in Your Controlled Group

Name	Address	Emp. ident. no.

1979 Department of the Treasury Internal Revenue Service

Instructions for Schedule N (Form 1120-DISC)

Export Gross Receipts of the DISC and Related U.S. Persons

(References are to the Internal Revenue Code)

General Instructions

1. Purpose of Schedule N (Form 1120-DISC).—This schedule must be completed and attached to Form 1120-DISC to report:

(a) export gross receipts of the DISC by product code;

(b) export gross receipts of the DISC and related U.S. persons in the current year by country;

(c) export gross receipts of the DISC and related U.S. persons in preceding years; and

(d) the name, address, and identifying number of related U.S. persons.

If the lines on this schedule are not sufficient, attach additional copies of Schedule N.

2. Export Gross Receipts.—These are receipts from:

(a) the sale for direct use, consumption, or disposition outside the U.S. of property (such as inventory) produced in the U.S.;

(b) the lease or rental of such property to unrelated persons for use outside the U.S.;

(c) services related and subsidiary to a sale described in (a), or a lease or rental described in (b);

(d) engineering or architectural services for construction projects outside the U.S.; and

(e) export management services.

In the case of commission sales, "export gross receipts" include the total receipts on which the commission was earned. (See section 995(e)(4).)

Note: For purposes of Schedule N only, no reduction is to be made for receipts attributable to military property. Therefore, a DISC's "export gross receipts" for purposes of Schedule N should be taken from line 13(a), Part II, Schedule J (Form 1120-DISC 1979) for the current taxable year; from line 13(a), Part II, Schedule J (Form 1120-DISC 1978) for taxable years beginning in 1978; from line 13(a), Part II, Schedule J (Form 1120-DISC 1977) for taxable years beginning in 1977; from line 13(a), Part II, Schedule J (Form 1120-DISC 1976) for taxable years beginning in 1976; and from column C, lines 6(a) through 6(e), Part II, Schedule J (Form 1120-DISC 1979) for taxable years beginning in 1972 through 1975.

3. U.S.—U.S. includes the Commonwealth of Puerto Rico and possessions of the U.S. (See section 993(g).)

4. Geographic Source of Export Gross Receipts.—The geographic source of export gross receipts from the sale of property is the country of ultimate destination of the property, or the country in which the property is consumed or further processed to the best of the DISC's knowledge. However, all receipts from sales by a DISC to a second DISC have the U.S. as their geographic source for purposes of Schedule N, regardless of the disposition of the property by the second DISC. For non-DISC related U.S. persons, all receipts from sales to or through a related or unrelated DISC, and from sales of property ultimately destined for the U.S., are to be excluded from "export gross receipts" and therefore not reported on Schedule N.

The geographic source of export gross receipts from the lease or rental of property is the country in which the property is located.

The geographic source of gross receipts from the provision of services is the country in which the purchaser is located.

5. Related Persons.—The following are "related persons":

(a) an individual, **partnership**, trust, or estate which **controls** the DISC;

(b) a corporation which controls, or is controlled by the DISC; and

(c) a corporation which is controlled by the same person or persons who control the DISC.

In the above, "control" means direct or indirect ownership of more than 50% of the total combined voting power of all classes of stock entitled to vote. (See section 993(a)(3).)

6. U.S. Person.—A "U.S. person" is:

(a) a citizen or resident of the U.S.;

(b) a domestic corporation or partnership; or

(c) any estate or trust (other than a foreign estate or trust, within the meaning of section 7701(a)(31)).

Specific Instructions

A. Export Gross Receipts of the DISC by Product Code.—Product code numbers and percentages of export gross receipts are reported in the information block in the upper right-hand corner of page 1, Schedule N. Using the product code system on page 2 of these instructions, enter the code number for the major product or service (as measured by export gross receipts) sold or provided by the DISC in the first column of the first line of the information block. Enter the percentage of total export gross receipts accounted for by this product or service in the second column of the first line. Enter the same information on the second line for the next largest product or service (as measured by export gross receipts) sold or provided by the DISC.

Example: A DISC has export gross receipts of $10 million. The sale of agricultural chemicals accounts for $4.5 million (45%) of that amount, the largest product or service sold or provided by the DISC. The number "287" (the product code for agricultural chemicals) should be entered in the first column, and 45% in the second column of the first line. The sale of industrial chemicals accounts for $2 million (20% of $10 million), the second largest product or service sold or provided by the DISC. The number "281" (the product code for industrial chemicals) should be entered in the first column and 20% in the second column of the second line.

B. Part I.—If two or more DISCs are related persons, only the DISC with the largest export gross receipts should complete columns 3 and 4 in Sections A and B. All DISCs should complete columns 1 and 2 in both Sections.

Period for which Information is to be Furnished for Related U.S. Persons.—Furnish the information required in columns 3 and 4 for the related DISCs' and other related U.S. persons' annual accounting periods ending with or within the DISC's taxable year.

Section A—Export Gross Receipts in the Current Year by Country.—The receipts from any transaction should be reported only in one column. If a DISC acts as a commission agent for a related person, the total amount of the transaction should be attributed to the DISC.

(1) Column 2—Export gross receipts of the DISC.—Complete column 2 to report the geographic source of the DISC's export gross receipts from all souces (including the U.S.) for the taxable year.

(2) Column 3—Export gross receipts of related DISC's.—Complete column 3 to report the geographic source of all related DISCs' export gross receipts from all sources (including the U.S.).

(3) Column 4—Export gross receipts of all other related U.S. persons.—Complete column 4 to report the geographic source of all other related U.S. persons' export gross receipts from all sources except the U.S.

Section B—Export Gross Receipts in Preceding Years.—Complete Part I, Section B to report the export gross receipts of the DISC, all related DISCs and all other related U.S. persons for each taxable year of the DISC beginning on or after January 1, 1972.

If any of the prior year DISC export gross receipts were adjusted to exclude gross receipts from property which does not currently qualify as export property under section 993(c)(2), attach a schedule showing the amount of the adjustment for each year for each DISC in the related group. Include the adjustments for each year in the export gross receipts of the "all other related U.S. persons" (column 4) as if the export had not originally been made through the DISC.

C. Part II.—Report the name, address, and identifying number of related U.S. persons in your controlled group on Schedule N, page 2.

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